SMALL BUSINESS DEVELOPMENT CENTER PROGRAM (Part 3)

HEARING

BEFORE THE

COMMITTEE ON SMALL BUSINESS HOUSE OF REPRESENTATIVES

NINETY-EIGHTH CONGRESS

SECOND SESSION

WASHINGTON, DC, APRIL 4, 1984

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SMALL BUSINESS DEVELOPMENT CENTER PROGRAM

(Part 3)

WEDNESDAY, APRIL 4, 1984

HOUSE OF REPRESENTATIVES,
COMMITTEE ON SMALL BUSINESS,
Washington, DC.

The committee met, pursuant to notice, at 9:10 a.m., in room 2359-A, Rayburn House Office Building, Hon. Neal Smith (acting chairman of the committee) presiding.

OPENING STATEMENT OF ACTING CHAIRMAN SMITH

Mr. NEAL SMITH. The committee will come to order.

I'm sorry to report the chairman lost a member of his family last night and he won't be here this morning but at his request we'll proceed with the hearings.

This morning we are here to receive the testimony on the Small Business Development Center Improvement Act of 1984.

In 1980, Congress enacted legislation to establish the Small Business Development Center Program to provide management assistance to the small business community. Under this program, any entity may apply to SBA to be designated as a small business development center and receive Federal funds to pay up to one-half of the cost of the center.

To date, SBA has approved SBDC's in 30 States and the District of Columbia. These SBDC's are operated primarily by universities and have provided assistance to more than 260,000 small firms.

Public Law 96-302 sunset the program at the end of fiscal year 1984 and, as an interim measure, it was extended for 3 months by Public Law 98-177.

Last year the committee initiated its review of the program and field hearings were held in Atlanta, GA, Seattle, WA, and Columbia, SC. At these hearings we received testimony from the centers, from State and university officials and, most importantly, from numerous small businesses who had received assistance from these centers.

As a result of these hearings, Chairman Mitchell introduced this legislation. H.R. 5334 will extend the program for 4 additional years and make improvements in it to provide what I hope will be better management assistance to small businesses.

This morning we'll hear from three panels of witnesses. The first panel will consist of two individuals who were outstanding State di-

rectors of this program when it was really in its infancy. The third individual is a management consultant who had proposed the development of this type of program over 10 years ago.

The second panel will consist of individuals from SBA, and the third panel are State directors from four SBDC's.

Mr. McDade.

OPENING STATEMENT OF HON. JOSEPH M. McDADE, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF PENNSYLVANIA

Mr. McDade. Thank you, Mr. Chairman, and I want to welcome our witnesses this morning on the small business development program. We are all very interested in hearing your testimony.

In my own State of Pennsylvania we have an excellent program headed by Susan Garber of the University of Pennsylvania. She is also the president of the Association of Small Business Development Centers, and is with us this morning.

As an original sponsor of this legislation, it gives me a lot of satisfaction to see what was begun in 1977 on a pilot basis in one university grow to a national network, reaching out to provide state of the art management counseling to America's small businesses.

The program has already made a large contribution to the economic well-being of the Nation through its assistance to the small business sector and we are all very interested in the legislation that has been reintroduced to continue them.

Thank you, Mr. Chairman.

Mr. Neal Smith. Any other statements? Mr. Conte.

OPENING STATEMENT OF HON. SILVIO O. CONTE, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF MASSACHUSETTS

Mr. Conte. Thank you, Mr. Chairman. I want to thank you for having these hearings, Mr. Chairman. They address a very important small business program, the Small Business Development Centers.

Since we established these centers in 1980, they have helped thousands of small businessmen with management, capital formation, marketing and all of the hundreds of problems faced by small business each and every working day.

I would like to make a special welcome to one of the witnesses today on panel three, John Ciccarelli of Massachusetts. He is director of the Massachusetts Small Business Development Center in Amherst, in my district, and under John's leadership the Massachusetts SBDC has developed into a model program that is respected by State centers across the country.

Before you think I'm beating the drum about one of my constituents, let me tell you one more thing.

John has recently been elected vice president of the National Association of Small Business Development Centers and I'm sure his comments about this program will prove to be a valuable contribution for the record.

Thank you for coming here today, John, and we welcome your testimony.

Thank you, Mr. Chairman.

Mr. BILIRAKIS. Mr. Chairman, I have an opening statement, if I may, sir.

Mr. NEAL SMITH. All right.

OPENING STATEMENT OF HON. MICHAEL BILIRAKIS, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF FLORIDA

Mr. BILIRAKIS. I am pleased, sir, that you have called this hearing today on the extension of the Small Business Development Center Program. I'm fortunate that I have a Small Business Development Center which is located on the main Tampa campus of the University of South Florida and which serves my constituents.

My impression of the activities of this SBDC is very favorable and this is shared by many small businessmen and women whom I represent. I've worked closely with the SBDC in developing programs for small businesses in my district and have always found them to be exceptionally helpful, knowledgeable and committed to the cause of small business.

However, Mr. Chairman, in spite of my strong support of the SBDC's, I understand there are small business groups opposed to them. I don't know the particulars of this opposition since I have, just within the last couple of days, been made aware of the bill which, as I understand, is to go to immediate markup.

Since this committee has made it a practice to air both sides on pending legislation, I look forward to keeping an open mind as we hear the pro and con testimony.

Thank you, Mr. Chairman.

Mr. NEAL SMITH. Mr. Daub.

OPENING STATEMENT OF HON. HAL DAUB, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF NEBRASKA

Mr. DAUB. Mr. Chairman, thank you very much.

As we begin the process of reauthorizing the Small Business Development Center Program, we have the opportunity to review and reevaluate this program's relatively short history.

With the aid of testimony we'll hear this morning, as well as our own personal experiences with individual Small Business Development Centers, we can hopefully identify the sources of strength and eliminate any problems that we see developing.

In terms of my own State, Mr. Chairman, I couldn't be prouder of the energy, dedication, expertise, and spirit which seems to emanate out of our Small Business Development Center in Nebraska, and let me say from the outset that it is my firm belief that the primary reason for the documented successes of the Nebraska Business Development Center is that we in Washington have not hamstrung its local administrators with excessive regulations or directives.

Having sufficient flexibility, the Nebraska Business Development Center is thriving and succeeding beyond the hopes of the original drafters of this program I suspect, because of old-fashioned ingenuity, creativity, and hard work, and because we are respecting the fact that the local folks know best how to serve the needs of the local business communities.

I'm looking forward to the input from all of those who are scheduled to testify this morning, Mr. Chairman. It is going to be my pleasure later to introduce Mr. Bob Bernier, who is the fourth member of our third panel this morning, and indeed he has a distinguished record and their programs have been given outstanding awards from the American Assembly of Collegiate Schools of Business, and indeed he has been recognized by Freedoms Foundation for their work not only in serving women but in terms of their entreprenurial and free enterprise system, so I'm going to be very pleased to introduce him shortly and we'll elaborate more when that opportunity comes along.

Mr. Chairman, I want to compliment you and Mr. Smith as well, for I know you were originally very interested and innovative in helping to create this program and are an original sponsor of the bill and I look forward today to hearing our witnesses.

Mr. NEAL SMITH. Mr. Bedell, do you have——

Mr. BEDELL. I do not.

Mr. NEAL SMITH. Will Mr. Cowart, Mr. Bramblett and Mr. Komivis come up to the table, please?

While you're being seated, I had the pleasure of being in Oklahoma last Friday. They are in the process of establishing an SBDC there. When we established the SBDC Program, we insisted that there be at least 50 percent local money from non-Federal sources—I mean the matching funds could not include any program that had Federal money in it. They told me that meeting the matching funds requirement was one reason that they got started slowly, but it made sure that they were really going to have a locally directed program that they were really interested in.

Who wants to go first?

TESTIMONY OF ALLAN B. COWART, FORMER DIRECTOR, FLORIDA SMALL BUSINESS DEVELOPMENT, AND DIRECTOR, EGLIN AFB AND FORT WALTON BEACH CENTERS, THE UNIVERSITY OF WEST FLORIDA

Mr. COWART. I will, sir. My name is Allan Cowart and I'm from Florida. I have been with the program quite a long time.

Congressman Smith and gentlemen, thank you for asking me to appear before you and the committee to discuss the appropriateness of continuing the Small Business Development Center Program.

After 10 years of developing and directing programs to aid small business, I left the SBDC Program almost 2 years ago to assume a position in university administration.

This 2-year break allows me to view more objectively where the SBDC Program has been, where it is and what it has done for the small business community.

Although I will speak principally to the Florida program, I believe that much of what I have to say applies to the national program.

Florida has always made its program elements available to all SBDC's and other SBDC's have made their programs available to Florida. There is no "not invented here" syndrome to overcome in the national SBDC network.

A brief history of the Florida program may be useful to establish the need for management assistance from a university base to the small business community.

The University of West Florida was only 5 years old as a university when it began to seek additional methods to fulfill its charge to deliver public service. Because I had, in earlier years, been a small businessman and was seeing the same errors made that I had made 30 years earlier, and because I, as a management faculty member, could do something about those errors, I suggested that the university establish a community service to assist its small business community.

Our initial experience reflected an unfulfilled need for assistance to the marketplace.

In January 1973, using SBA Program attendance projections to determine needs for SBA literature handouts and to determine appropriate facilities, the new program inaugurated an eight workshop series in three locations of the Florida Panhandle.

At the first location, an attendance of 40 was projected, but 160 persons showed up. An attendance of 60 was expected at the second location, but 325 showed. In Pensacola, our largest city, we were advised to expect a hundred people but acting on the previous evening's results in two locations we arranged for 200 with an overrun of 400 people, but 800 overwhelmed the university campus facility.

Although considerable confusion existed, radio and TV announcements guided patrons to suitable facilities for the ensuing week's workshops and the SBA documents section in Washington responded magnificently to our needs.

The inordinate attendance figures were perplexing, inasmuch as only 27 responses were received to a 3,000 mailout questionnaire. Nevertheless, we were convinced that a very strong need existed for small business management assistance and that the university had indeed found a viable community service.

SBA was attracted by the success of the program and continued to support the principal need for documents. The university was tendered a modest contract by SBA for Small Business Institute activities in October 1972. Thus, small business assistance became formalized in the classroom and provided another consulting resource for the SBDC, then called in our parlance a Resource Center for Small Business Management, but for consistency I would like to use the term SBDC.

Workshop and individual counseling attendance continued to flourish until the fuel crisis of 1974. We minimized this crisis by developing, producing and airing a 13-week television series written by SBDC staff and assisted by a cooperative television station in Mobile, AL, WALA–TV. We could carry important parts of our program to the people and conserve their automobile fuel. A Neilsen rating indicated a weekly audience of 9,700 people. That's not very much, I suppose, in a big community like this, but in our community it was quite a bit.

At about the same time, in order to further serve the small business community, the SBDC established "mini libraries" in very small communities. They would augment the television program with appropriate literature. Accompanying instructions asked pa-

trons to contact the SBDC if there were any problems in comprehending the literature.

Also, about the same time there were established consulting centers and comprehensive libraries in larger chambers of commerce. The SBDC began a quarterly publication with current items of interest, and a 3-month workshop schedule which it mailed to previous workshop attendees and consulting clients, and I have an attachment to describe that process, sir.

Progress continued as new workshops and publications were developed. Of special note was the development of a program called "Info-Bid." It is an automated system to match small contractors with government and private contracts and to mail appropriate notices of IFB's to those contractors.

This service is augmented by a workshop on, "How to Bid on Government Contracts and Others." This program has generated literally millions of dollars in contracts for the small contractor that otherwise would have been lost.

While the early overall program was inordinately successful in a 10-county area of some half-million people, it was obvious that a statewide presence was needed.

Consequently, following the formal declaration of the University of West Florida as an SBDC, then called a UBDC in 1976, efforts began to involve the entire State.

Startup, however, did not occur until January 1980 at which time it could be stated that management assistance was being delivered to small businesses from Pensacola to Key West. State funds to match Federal funds were slow in coming and for 3 years each university campus had to generate matching funds at the expense of other campus programs.

During the developmental and subsequent phases of the SBDC, great care was exercised not to encroach upon the very people we wanted to help, the small professional firm.

We have been unusually successful at this with client referrals coming from professional management consultants, attorneys, banks, accountants, and other professionals.

The principal thrust of the SBDC is to educate, not merely deliver services. Once the professional community ascertained this, there was no reluctance on their part to cooperate fully.

SBDC's do coordinate and cooperate with literally scores of Government and private sector organizations. The resulting infrastructure of cooperation strengthens the program immensely.

One such national body is the Young Lawyers Division of the American Bar Association, who in cooperation with Florida SBDC's produce an excellent reference guide. Attachment B cites the foreword by the SBA administrator, the contents and introduction by the author.

Is the SBDC program really effective? A study spanning 5 years of SBDC clients in two counties of the Florida Panhandle was conducted in 1981. It was determined that the failure rate for this group of businesses was not 66⅔ percent as SBA reports the national 5-year failure performance to be, but approximately 12.4 percent.

In a separate study of a smaller grouping, in two smaller counties, the failure rate was 8.54 percent.

Because this is a dramatic difference from SBA failure rates, the parameters used should be explained.

A 2-countywide area was used, of 235,000 population. The group consisted of all SBDC clients who had approximately 12 hours or more of training and consulting with the local SBDC, and who had actually opened their doors for business. The sample population of 191 client businesses were both in populated and agarian areas.

In addition, SBDC counseling resulted in some 45 clients not going into the marketplace because of a lack of preparation, and while we don't count this, we feel it is a most important part of the SBDC program because it cuts down on an immense number of failures.

In terms of the program's ability to produce intended results, several convincing examples are available.

(a) In 1981, the Florida Advisory Council on Intergovernmental Relations, called ACIR, composed of some 12 State senators, legislators, and management personnel from all over the State, stated after an onsite review of the University of West Florida SBDC that, "the Small Business Development Centers represent Florida's best opportunity to not only curb the failure rate of the small firm, but also to provide the means by which a stronger, more diversified economy may be obtained."

(b) Employment by SBDC clients increased at a rate of 48 percent as compared to 5 percent for all Florida businesses.

(c) Profits increased for SBDC clients at a rate of 175 percent as compared to 18 percent for all Florida businesses. Now, I note that since most SBDC clients start with small employment and small profits, one may expect dramatic gains.

(d) Increases in sales and profits and employment result in additional revenues to units of Government and, if I may, I would like to just read the impact of SBDC counseling in Florida on Government revenues for the years 1981–82:

The ratio of benefits to cost for State funds expended was 11.74 to 1. That is, for every $1 provided by the State, the benefits in tax dollars of $11.74 were realized.

In Federal dollars, the ratio was 18.73. For every dollar expended by the Federal Government on behalf of our program, the resulting tax return was $18.73.

Federal dollars expended per client hour of management assistance in Florida is most attractive. It's $10.66 in 1983, compared to $10.48 in 1982. This represents 146,000 client hours of management assistance divided into the total Federal funds of $1.559 million.

The program continues to grow. I have an attachment which compares 1981, 1982, and 1983, to indicate the growth rate. There were 50 percent more attendees at training programs in 1983 than in 1982, and 39 percent more attendees training hours delivered. There was 37 percent more attendance at 27 percent more speaking engagements, and the Federal cost per hour of assistance rose only 2 percent.

Neither the amount of inquiries to SBDC's, which increased 108 percent, nor the speaking engagement figures are calculated in Federal cost per hour figures.

There is little question that the SBDC Program should continue to and receive increased support in view of (1) the growth in

demand of services, (2) Federal and State tax revenues increasing, (3) businesses saved from failure, (4) growth in emplovment of SBDC client businesses, and (5) providing economic education to strengthen the small business sector.

The Small Business Administration administrator states that bv the end of 1984 35 States will have SBDC programs. Of course, this is dependent on your disposition of the legislation. However, it reflects the support of a conservative Federal agency.

The marriage between the Small Business Administration and State university systems is working to the advantage of the Nation. The program is stronger than ever because it is the right program at the right time.

Thank you, Mr. Smith, and gentlemen.

[Mr. Cowart's prepared statement with attachments follows:]

PREPARED STATEMENT OF ALLAN B. COWART, FORMER DIRECTOR, FLORIDA SMALL BUSINESS DEVELOPMENT, AND DIRECTOR, EGLIN AFB AND FORT WALTON BEACH CENTERS, THE UNIVERSITY OF WEST FLORIDA

Thank you, Mr. Chairman, for asking me to appear before you and the committee to discuss the appropriateness of continuing the Small Business Development Center (SBDC) program.

After ten years of developing and directing programs to aid small businesses, I left the SBDC program almost two years ago to assume a position in university administration. This two-year break allows me to view more objectively where the SBDC program has been, where it is and what it has done for the small business community. Although I will speak principally with respect to the Florida program, I believe that much of what I have to say applies to the national program. Florida has always made its program elements available to all SBDC's, and other SBDC's have made their programs available to Florida. There is no "not invented here" syndrome to overcome in the national SBDC network.

A brief history of the Florida program may be useful to establish need for management assistance from a university base to the small business community.

The University of West Florida was only five years old when it began to seek additional methods to fulfill its charge to deliver public services. Because I had, in earlier years, been a small businessman and was seeing the same errors made that I had made thirty years earlier, and because I, as a management faculty member, could do something about those errors, I suggested that the University establish a community service to assist its small business community. Our initial experience reflected an unfulfilled need for assistance to the marketplace. (See Attachment "A" for abbreviated history.)

In January 1973, using SBA program attendance projections to determine needs for SBA literature handouts and to determine appropriate facilities, the new program inaugurated an eight-workshop series in three locations of the Florida Panhandle. At the first location an attendance of 40 was projected, but 160 persons appeared. An attendance of 60 was expected at the second location, but 325 showed up. And in Pensacola, our largest city, we were advised to expect 100 people, but acting on the previous evening's results in two locations, we arranged for 200 with an overrun of an additional 400, but 800 people overwhelmed The University Campus facility. Although considerable confusion existed, radio and T.V. announcements guided patrons to suitable facilities for the ensuing week's workshops and the SBA documents section in Washington responded to our needs. The inordinate attendance figures were perplexing inasmuch as only 27 responses were received to a 3,000 mailout questionnaire; nevertheless, we were convinced that a very strong need existed for small business management assistance and that The University had found a viable community service.

SBA was attracted by the success of the program and continued to support the principal need for documents. The University was tendered a modest contract by SBA for Small Business Institute (SBI) activities in October of 1972; thus, small business assistance became formalized in the classroom and provided another consulting resource for the SBDC.

Workshop and individual counseling attendance continued to flourish until the fuel crisis of 1974. This problem was

minimized by the development, production and airing of a 13-week television series written by SBDC staff and assisted by a cooperative television station in Mobile, Alabama, WALA-TV. We could carry important parts of our program to the people and conserve their automobile fuel. (A Neilsen rating indicated a weekly audience of 9,700.)

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Also, about the same time, there were established consulting centers and comprehensive libraries in larger Chambers of Commerce.

The SBDC began a quarterly publication with current items of interest and a three-month workshop schedule which it mailed to all workshop attendees and consulting clients. (See Attachment "B.")

Progress continued as new workshops and publications were developed. (See Attachment "C.") Of special note was the development of a program called "Info-Bid." It is an automated system to match small contractors with government and private contracts and mail appropriate notices of IFB's. This service is augmented by a workshop on "How to Bid on Government Contracts and Others." This program has generated millions of dollars in

contracts for the small contractor that, otherwise, would have been lost.

While the program was inordinately successful in a ten-county area of some 550,000 people, it was obvious that a statewide presence was needed. Consequently, following the formal declaration of The University of West Florida as an SBDC in 1976, efforts began to involve the entire state. Start up did not occur until January 1980 at which time it could be stated that management assistance services were being delivered to small businesses from Pensacola to Key West. State funds to match federal funds were slow in coming and for three years each university campus had to generate matching funds at the expense of other campus programs.

During the developmental and subsequent phases of the SBDC, great care was exercised not to encroach upon the very people we wanted to help--the small professional firm. We have been unusually successful at this with client referrals coming from professional management consultants, attorneys, banks, accountants, and other professionals. The principal thrust of the SBDC is to educate--not merely deliver services. Once the professional community ascertained this, there was no reluctance on their part to cooperate fully.

SBDC's coordinate and cooperate with literally scores of government and private sector organizations. The resulting infrastructure of cooperation stengthens the program immensely. One such national body is The Young Lawyers Division of the American Bar Association who, in cooperation with Florida SBDC's, produce an

excellent reference guide. (See Attachment "D" for SBA Administrator's Foreword, Contents and Introduction.)

Is the SBDC program effective? A study spanning five years of SBDC clients in two counties of the Florida Panhandle was conducted in 1981. It was determined that the failure rate for this group of businesses was not 66 2/3% as SBA reports the national five-year failure performance to be, but approximately 12.4%. Because this is a dramatic difference, the parameters used should be explained:

a. A two-county-wide area was used. (235,000 population.)
b. The group consisted of all SBDC clients who had approximately 12 hours or more training/consulting with the local SBDC and actually opened their doors for business.
c. The sample population was 191 client businesses.
d. Businesses were in both populated and agrarian areas.
e. In addition, SBDC counseling resulted in some 45 clients not going into the marketplace because of a lack of preparation.

In terms of the program's ability to produce intended results, several convincing examples are available:

a. In 1981 the Florida Advisory Council on Intergovernmental Relations (ACIR) (composed of some 12 state senators, legislators, mayors and management personnel from over the state) stated after an on-site review of the UWF SBDC: ". . . the Small Business Development Centers represent Florida's best opportunity to not only curb the failure

rate of the small firm, but also to provide the means by which a stronger, more diversified economy may be obtained."

b. Employment by SBDC clients increased at a rate of 48% as compared to 5% for all Florida businesses.

c. Profits increased for SBDC clients at a rate of 175% as compared to 18% for all Florida businesses. (Note: since most SBDC clients start with small employment and small profits, one may expect such dramatic gains.)

d. Increases in sales, profits and employment result in additional revenues to units of government:

Impact of SBDC Counseling in Florida
on Government Revenues, 1981-1982
(Estimated Tax Revenues Generated by Increased Sales, Employment and profits)

	Estimated Tax Revenue Increase in 1981-82	Funds Expended by SBDC 1981-82	Ratio: Benefits to Cost
STATE	$11,270,456	$ 960,252	11.74
FEDERAL	15,148,123	808,861	18.73
TOTAL	$26,418,579	$1,769,113	14.93

Federal dollars expended per client/hour of management assistance in Florida is most attractive: $10.66 compared to $10.48 for 1982. This represents 146,332 client/hours of management assistance divided into total federal funds of $1,559,224.

Program demand continues to grow. (See Attachment "E" for comparison of 1981, 1982 and 1983 services delivered and funds

expended.) There were 50% more attendees at training programs in 1983 than 1982 and 39% more attendee/training hours delivered. There was 37% more attendance at 27% more speaking engagements. And the federal cost per hour of assistance rose only 2%. (Neither the amount of inquiries which increased 108% nor the speaking engagement figures are included in federal cost per hour calculations.)

There is little question that the SBDC program should continue and receive increased support in view of:

1. Growth in demand of services
2. Federal and State tax revenues increase
3. Businesses saved from failure
4. Growth in employment of SBDC client businesses
5. Providing economic education to strengthen the small business sector

The SBA Administrator states that by the end of 1984, 35 states will have SBDC programs. Of course, this is dependent on your disposition of the legislation; however, it reflects the support of a conservative federal agency. The marriage between the SBA and state university systems is working to the advantage of the nation. The program is stronger than ever because it is the right program at the right time.

Thank you, Mr. Chairman and gentlemen.

FLORIDA SMALL BUSINESS DEVELOPMENT CENTERS

A State University System Program

December, 1982

Office of the Coordinator
University of West Florida
Suite H 117 Hospital Drive
Fort Walton Beach, FL 32548

PARTICIPATING INSTITUTIONS

Florida State University
Tallahassee

Florida A. & M. University
Tallahassee

University of South Florida
Tampa

Florida Atlantic University
Boca Raton

University of West Florida
Pensacola

University of Central Florida
Orlando

Florida International University
Miami

University of North Florida
Jacksonville

A

History of Florida Small Business Development Centers

(All activities have been and are in cosponsorship with the Small Business Administration and Chambers of Commerce.)

OBJECTIVE: Provide programs and services to independent businesses in order to:

1. Assist in developing the economy in the State of Florida.
2. Increase the probability of success for new business ventures.
3. Promote orderly growth for existing businesses.
4. Develop a strong scholastic program to enhance long-range economic stability for the student who selected independent business as his preferred livelihood.

JULY 1, 1972: UWF's Resource Center for Small Business Management began to function officially. Community services for ten counties of the Panhandle started. Funded at an initial level of $43,000 by the MDTA, a faculty member, management analyst, secretary, and student assistant comprised the team. Programs, literature, libraries, and delivery systems were developed and provided the small business community.

OCTOBER, 1972: Appointed one of 36 original Small Business Institute facilities by the Small Business Administration. This program provides for graduate students and highly qualified seniors, under the guidance of faculty, to provide consulting services to small businesses on-site. The program continues throughout the Panhandle and at some 450 other institutions in the nation.

NOVEMBER, 1972: The concept of serving outlying communities was developed and "Mini-libraries" of 300 small business documents presented to 15 Chambers of Commerce in the Panhandle. An additional 15 were subsequently presented. This concept was adopted by SBA Washington, tested in Colorado and is now in use in many states.

Attachment "A"

JANUARY, 1973: Small business training programs of eight weeks duration were conducted simultaneously in Panama City, Fort Walton Beach and Pensacola attracting some 1300 participants.

JULY, 1973: Funding under MDTA was increased to $60,000, new training modules were developed and conducted. The Jacksonville Chamber of Commerce asked the director to present the UWF program to them. Other Florida and out-of-state institutions became interested and were provided UWF's programs. Coordination with State agencies began, particularly the Economic Development Division of the Department of Commerce.

JULY, 1974: Funding under CETA at $60,000.

Fuel shortage encouraged the research, development, and production of a 13-week television series on small business. Purpose was to carry the programs to the people so that they could save their gasoline for income-producing purposes. New program modules were developed and delivered. Coordination with some SUS institutions and out-of-state institutions increased.

JULY, 1975: Funding continued under CETA at a level of $60,000. Program delivery expanded to all military installations with workshops conducted and additional "mini-libraries" placed. Close coordination began with U.S. Department of Commerce, area Community Colleges and Agricultural Centers.

MAY, 1976: Designated by SBA as one of six University Business Development Centers to cooperate in developing a national program to aid small businesses. Other universities were California, California Polytechnic, Nebraska, Maine, and Rutgers. Missouri and Georgia were subsequently added.

JULY, 1976: Funding continued under CETA at $15,000 to extend the fiscal year from July through September.

OCTOBER, 1976: Funding acquired under Coastal Plains Regional Commission at a level of $124,000. Additional Consulting and Programs offices opened at Panama City and Pensacola. The concept of Small Business Service Centers was developed and two were inaugurated at Bay County Chamber of Commerce and Pensacola Area Chamber of Commerce, provided expanded one-on-one consulting capabilities.

JANUARY, 1977: Gulf Coast Community College agreed to house UWF's new Eastern Region office and cosponsored activities began. Arrangements were made with Chipola Junior College to install a small business library and to conduct workshops and individual consulting.

MARCH, 1977: First funding received from SBA for SBDC program, $40,000 to deliver services.

APRIL, 1977: The Small Business Development Center director testified before the U.S. Senate Committee on Small Business in support of S.972, Small Business Development Center Act of 1978. Later, two clients who had received services from the SBDC also testified.

JULY, 1977: First State funding received, $30,000.

OCTOBER, 1977: Additional SBDC funding received from SBA, $80,000.

SUS advised that they intended to submit a line item request to achieve program core funding. Such will demonstrate State support which is required by SBA and S.972 should it be enacted. Assuming a successful state plan, Florida stands to receive one to two million dollars annually if it can match 25% funding. Best estimates are that the Bill (S.972), now in the House, having passed the Senate, will begin to move during the Spring and become effective October 1, 1978. There is a possibility that reference to the Conference Committee could delay movement.

JANUARY, 1978: A Special Group Emphasis Entrepreneur Center was established to address the special needs of women and minorities entering the marketplace. SBA provided $40,000 to support this function.

The Secretary of Commerce, Juanita M. Krepps, designated the University of West Florida's Small Business Development Center as Associate Office of the U.S. Department of Commerce.

FEBRUARY, 1978: UWF's SBDC facility formally dedicated by Governor Askew, Senator Childers, Chancellor York, and SBA Administrator Weaver after almost six years of research, development and assistance to small businesses.

The director testified before the U.S. House Committee on Small Business in support of Omnibus Bill HR 11445, Title III.

MARCH, 1978: Dedicated a new Small Business Service Center in the black community in Pensacola. It is equipped for full consulting and manned daily.

SBA/MAO joined SBDC.

APRIL, 1978: Director appointed by Governor Askew to the Governor's Small Business Advisory Council and was elected Chairman.

MAY, 1978: First meeting with Board of Regents to develop State Small Business Development Center Program. Draft of an SBDC state plan prepared by UWF for presentation to SUS participants plus the University of Miami.

JUNE, 1978: SBDC hosted SBA/ARDMA meeting in Pensacola.

JULY, 1978: Second-year funding for UWF/SBDC from the State, $127,429, received. Link-up with University of Oregon Innovation Center.

OCTOBER, 1978: Continued funding by SBA received, $154,750, to include special services of: Special Group Emphasis Center, Client Assessment Center, and Accounting Information System Development Center. Director elected to Executive Board of SBDC Director's Association.

Final approval of Board of Regents for the State Plan to implement a statewide SBDC. State Budget plan for $2.5 million submitted by BOR.

Director attended White House Conference on Small Business in Miami; elected a delegate to White House Conference on Small Business to be held in Washington, D.C. in 1980.

Interfaced with the University of North Carolina to present OSHA workshops in Panhandle.

Director advised of his appointment as Chairman of the Jacksonville District Advisory Council, Small Business Administration, with term to begin January, 1979.

UWF appointed by BOR as FSBDI host institution for statewide program.

Began operation of Accounting Information Systems Development Center.

Hosted National SBDC Director's meeting at which SBDC Director's Association was formed.

December, 1978: Florida edition of "How to Proceed in Business - Legally" was offered to the Florida Business Community through UWF/SBDC.

JANUARY, 1979: SBDC hosted Small Business Advisory Council meeting (Governor's Council) on UWF campus.

APRIL, 1979: Began operation of Technical Assistance Center, providing STAC and Innovation process services.

JUNE, 1979: SBA/MAO returned to the Jacksonville District Office.

First FSBDI Advisory Board meeting called by UWF State Coordinator and conducted at UWF.

JULY, 1979: Bootstrap SBDC operation at other universities produced start-up funds on each campus to total $301,873.

SEPTEMBER, 1979: Received pledge of support from Governor's Office of Business Assistance.

Mr. Cowart received invitation from President Carter to attend White House Conference on Salt II.

OCTOBER, 1979: Mr. Cowart attended White House Conference on Small Business in Atlanta.

Continued funding by SBA received ($300,000). Decision by Director to hold UWF funding at FY '79 level and distribute remainder to state SBDC's as a small supplement to their pledges to the Chancellor. Florida SBDC Program expanded to include nine universities.

Made Statewide tour to all facilities and Key West.

Small Business Service Center dedicated and began operation at Milton.

NOVEMBER, 1979: Coordinator participated in the new Business Administration Building dedication and opening of the SBDC at the University of South Florida in Tampa.

JANUARY, 1980: SBDC start-up operations began at FSU, FAMU, UNF, UCF, FAU, FIU, and UM.

Mr. Cowart attended White House Conference.

MARCH, 1980: National meeting at Albuquerque of SBA, SCORE, SBI, SBDC, and Chambers to formulate national policy concerning SBDC.

APRIL, 1980: Received supplemental funding from Coastal Plains Regional Commission - $160,000.

Effected SCORE/SBDC Memorandum of Understanding between District SCORE Representatives and State Coordinator's Office.

JULY, 1980: National Legislation (PL 96-302) authorizing SBDC's.

AUGUST, 1980: SBDC's Florida Legislative Budget of $1.3 million to fund FSBDC's was submitted to BOR.

OCTOBER, 1980: SBA extended Florida SBDC contract for 1½ months and $57,500 funding.

Instituted new Management Information System for collecting and analyzing client data.

NOVEMBER, 1980: SBA extended Florida SBDC contract for 1 month and $50,000 funding.

DECEMBER, 1980: Received Cooperative Agreement from SBA for one year. Funding level for FSBDC was $762,500.

JANUARY, 1981: Coordinator's Office physically separated from Host Institution to Fort Walton Beach.

Effected Agreement to cooperate with State Chamber of Commerce.

FEBRUARY, 1981: 160 Billboards "Partnership in Progress" installed throughout the state as a cooperative venture between the Florida Chamber of Commerce and the State University System.

Affiliation established with the Young Lawyer's Division of the American Bar Association.

MARCH, 1981: Testified before Small Business Subcommittee in Tallahassee.

Received Legislative Staff for briefing on statewide program.

MAY, 1981: University of Miami withdrew from FSBDC's program.

JUNE, 1981: $5,000 Grant received for Technical Assistance for the Florida Oyster Industry.

Developed an Internal Audit Program (used by the National SBDC Director's Association).

JULY, 1981: Allan B. Cowart elected to serve a two-year term on the Executive Committee of the National SBDC Director's Association.

INFO BID system evolved. An automated system to inform Florida small businesses of government and private procurement opportunities.

SEPTEMBER, 1981: Received supplemental funding from SBA for increased activity and 16 day extension in the amount of $271,083.

Stetson University was added to the SBDC Consortium as a regional center under the University of Central Florida and was appointed as an SBI School.

Published the First Edition of "Starting and Organizing a Business - A Legal & Tax Guide for Small Businesses" in conjunction with the Young Lawyers Division of the American Bar Association.

OCTOBER, 1981: The Advisory Council on Intergovernmental Relations published a Final Narrative Report, after an in-depth study, which enthusiastically supported the Florida SBDC program.

Appointed by the Governor's Office to serve on "Policy Guide Committee on Economic Development."

DECEMBER, 1981: Oversight Committee of the Florida House Majority Leader's Office did a Legislative Summary Report on the Florida SBDC's.

Effected Memorandum of Understanding between the FSBDC and the Federal Laboratory Consortium.

Effected Memorandum of Understanding between the FSBDC and the Wisconsin Innovation Program.

JANUARY, 1982: Florida Keys Community College added to the FSBDC consortium as a regional center under the Florida International University.

Hosted National SBDCDA/SBA Conference at Navarre Beach.

FEBRUARY, 1982: Gainesville SBDC added to the FSBDC consortium.

MARCH, 1982: Received Cooperative Agreement from SBA to provide statewide SBDC operations in 1982 with federal funding of $1,202,918.

APRIL, 1982: Florida Atlantic University withdrew from FSBDC consortium.

JUNE, 1982: The University of South Florida SBDC instituted an aggressive circuit-rider program that effectively delivers basic services to all fifteen counties in its jurisdiction no matter how remote the business location.

JULY, 1982: Fort Lauderdale SBDC, under the State University System, began operation.

The Panama City SBRDC transferred from The University of West Florida program control center to the Florida State University Center.

The first edition of "Selecting a Professional Consultant" was published which guides the "graduating" SBDC client in choosing the proper consultant for his needs.

7th Printing of "A Recommended Loan Application Package," Volume I.

1st Printing of "A Recommended Loan Application Package," Volume II.

AUGUST, 1982: Received supplemental increase from SBA in the amount of $234,613.

SEPTEMBER, 1982: Allan B. Cowart, State Coordinator for FSBDC changed positions at UWF; however, continues association with the FSBDC as a Program Consultant.

OCTOBER, 1982: Hosted management audit teams from Centaur, Inc. and Berkeley Planning Associates, both under SBA contract to provide program impact and cost benefit analysis to 1983 congressional committees.

DECEMBER, 1982: The INFO-BID system to match small business contractors with procurement opportunities has completed its statewide implementation with all major SBDC's now participating.

Small Business Highlights

Issued quarterly by the Small Business Development Center, The University of West Florida, Pensacola, Florida 32514.
Co-sponsored by the Small Business Administration and local Chambers of Commerce as a service to the business community.

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APR.-JUN., 1984 VOL. 8, NO. 2

SBA PUBLICATIONS

Five new SBA publications have recently come off the press:

Feasibility Checklist for Starting a Small Business of Your Own (MA 2.026)
Understanding Your Customer (MA 4.001)
Creative Selling: The Competitive Edge (MA 4.002)
Productivity Management in Small Business (SBB 93)
Decision Making in Small Business (SBB 94)

All five publications are free. Write to the U.S. Small Business Administration, P.O. Box 15434, Fort Worth, Texas 76119.

SBA CRITERIA FOR SMALL BUSINESSES

The Small Business Administration has revised the criteria used to define a small business. These new size standards became effective on March 12, 1984. The standards vary for different activities so that the figures quoted below are generalizations, but representative of the ranges in various groups. The full and specific details appear in the Federal Register, Volume 49, No. 28.

The figures show the upper limits of size expressed as average gross annual sales for the last three years or the number of employees.

Retailers: $ 3.5 million (building supplies, bookstores, furnitures, etc.) to
$13.5 million (department and grocery stores, etc.)

Services: $ 3.5 million (restaurants, beauty shops, equipment rental) to
$14.5 million (motion pictures production)

Construction: $ 7.0 million —special trades (plumbing, heating, air conditioning, electrical, carpentry, roofing) to
$17.0 million —general contractors

Wholesalers: Up to 500 employees

Manufacturing: Generally up to 500 employees but some industries (petroleum, fabricating metal) up to 1,500

IRS—TAX DEPOSITS

The Internal Revenue Service has changed the methods by which tax deposits are made for any tax period after December 31, 1983. The computer key punch type card has been replaced with a coupon book—title, Federal Tax Deposit Coupon Book (Form 8109). The coupon book provides stub receipts for the business records and a re-order form. When using, depositors should exercise caution because the coupon book does not list the fiscal year/quarter of the deposit and the depositor must enter this information.

PRIDE OF PLACE

"Ever seen a good business surrounded by litter?" asked the young man.

"No, can't say I have," replied the old man, "but then when I was young folks didn't have so much to throw away."

"Would you buy from a business that has litter and trash visible to the customer?"

"Not if I could buy from a cleaner place."

(If the task is too big for you, contact your local Clean Community Commission.)

WOMAN BUSINESS OWNERSHIP CONFERENCE, 1984

The Woman Business Ownership Conference will be held on June 8 and 9, 1984 at the Orlando Hyatt (near Walt Disney World). The purpose of the program is to increase the number and prosperity of women business owners through continuing education and development of private sector support.

For further information, please contact the Small Business Development Center, University of Central Florida (305) 275-2796.

Small Business Procurement Assistance —UPDATE—

The Florida Small Business Development Center "Info Bid" Program has been upgraded to provide participating small businesses with an increased selectivity of opportunities for selling goods and services to government agencies and some commercial firms. The program change will accommodate a more precise match of available opportunities with the small business's areas of interest. This increased selectivity is accomplished by increasing the match code from four to five digits.

For those unfamiliar, the Info Bid program is an initial marketing tool to help interested small businesses identify those federal, state and local government agencies which repetitively buy goods and services that can be provided by the business. To participating businesses there are mailed weekly summaries of opportunities which have been extracted from the state data bank. Each summary contains a terse synopsis of the product, or services, desired along with the bid date, name of purchasing agency and the telephone number to obtain more information. Businesses are encouraged to request that their firm be added to those agencies whose mailing lists appear to offer continuing business opportunities. With the client business operator's concurrence, they are then dropped from the Info Bid mailing after they have located their market.

The new program called "Info Bid-2 Upgrade" provides the option of using the more precise match or keeping the former four digit match. For further information on this or any areas of procurement assistance, please call (904) 474-2919 or (904) 678-1143.

NOTICE—In order to reduce distribution expenses of this newsletter, recipients who have not attended a workshop or contacted the SBDC within the past two years will be dropped from the mailing list. If this applies to you and you would like to continue receiving this newsletter, please call or write your nearest SBDC office.

This public document was promulgated at an annual cost of $682.12 or $.1048 per copy to keep the Small Business community informed of new business developments. UWF 174-3-84.

The University of West Florida is an Equal Opportunity/Affirmative Action Institution

Attachment "B"

WORKSHOP SCHEDULE

This is a schedule for the four-county area served by the Small Business Development Center. Pre-registration is encouraged but not required. With every workshop, each evening contains different material—persons are advised to attend all sessions.

STEPS TO STARTING A BUSINESS

Subjects discussed are legal forms of business, taxation, financing, business location, insurance, and start-up capital requirements.

* Apr 2 & 3	Woodham High School	Pensacola	6:00-9:00 p.m.
Apr 17	H & O Cafe, 301 E. Gonzalez Street	Pensacola	6:30-9:30 p.m.
Apr 17 & 19	Chautauqua Neighborhood Center	DeFuniak Springs	6:00-9:00 p.m.
Jun 1 & 8	Base Education Center, Bldg. 251	Eglin AFB	1:00-4:00 p.m.
Jun 18 & 19	Gulf Breeze High School	Gulf Breeze	9:00 a.m.-12:00 p.m.
Jul 9 & 10	Pensacola Junior College, West Campus	Warrington	6:30-9:30 p.m.

* Please note change of location for this workshop.

SMALL BUSINESS WEEK

May 7-11	Programs, places and times to be announced.		

INTRODUCTION TO RECORDKEEPING

The basics of recordkeeping—designed as a forerunner to the full four sessions on "Recordkeeping in Small Business."

Jul 12	Tate High, Community & Adult Education School	Gonzalez	6:00-9:00 p.m.

RECORDKEEPING IN SMALL BUSINESS

Subjects include how to keep records, development of financial statements, depreciation and investment tax credits. A sample set of books is prepared for a new business.

May 3, 8, 15, 22 & 24	Crestview High School	Crestview	6:30-9:00 p.m.
Jul 11, 16, 23, 30 & Aug 6	OWJC/UWF Ft. Walton Beach Center	Ft. Walton Beach	6:30-9:00 p.m.
Jul 24, 26, 31 & Aug 2	Tate High, Community & Adult Education School	Gonzalez	6:00-9:00 p.m.

MANAGING FINANCES IN SMALL BUSINESS

Topics covered are accounting records, statements, ratio analysis, capital budgeting, types of financing, and planning for the future.

Apr 9 & 10	Pensacola Area Chamber of Commerce	Pensacola	6:30-9:30 p.m.
Jun 4 & 5	Pensacola Area Chamber of Commerce	Pensacola	6:30-9:30 p.m.
Jun 5 & 6	Crestview High School	Crestview	6:30-9:30 p.m.

ADVERTISING IN SMALL BUSINESS

Subjects covered are how to develop an effective advertising program, set up a budget, prepare the advertising message, distribute advertising funds, select the medium and evaluate the results.

Jun 19 & 21	Crestview High School	Crestview	6:30-9:30 p.m.

HOW TO BID ON GOVERNMENT AND PRIVATE CONTRACTS

Topics include how government buys goods and services, how to locate those agencies that routinely buy goods and services, sources of assistance for small business firms, how to evaluate and prepare a bid packet, how to obtain bonding, and current contracting opportunities.

Apr 23, 24 & 26	OWJC/UWF Ft. Walton Beach Center	Ft. Walton Beach	6:30-9:30 p.m.
Jul 16, 17 & 19	Pensacola Area Chamber of Commerce	Pensacola	6:30-9:30 p.m.

HOW TO PREPARE AND NEGOTIATE GOVERNMENT CONTRACTS

Topics include the new Small Business Innovation Research (SBIR) Program, how to prepare proposals, how proposals are evaluated and selected for negotiations, how to prepare for negotiation and negotiation techniques.

May 14	Fort Walton Beach Chamber of Commerce	Ft. Walton Beach	6:30-9:30 a.m.

WOMEN GOING INTO BUSINESS

Women speakers from the business community discuss their experiences and provide advice to women interested in starting their own business.

May 9	Holiday Inn	Pensacola Beach	9:00 a.m.-4:00 p.m.

THE ABC's OF BORROWING

Discusses the fundamentals of borrowing and how to complete a loan application package.

May 22	H & O Cafe, 301 E. Gonzalez Street	Pensacola	6:30-9:30 p.m.

HOW TO DO A FEASIBILITY STUDY

Subject matter includes a survey of factors pertinent to doing a feasibility study for the establishment of a small business.

Apr 3 & 5	Niceville High School	Niceville	6:30-9:30 p.m.
Apr 10 & 12	OWJC/UWF Ft. Walton Beach Center	Ft. Walton Beach	6:30-9:30 p.m.
Apr 23 & 24	Pensacola Area Chamber of Commerce	Pensacola	6:30-9:30 p.m.

TIME MANAGEMENT

An introduction to the techniques of managing one's time.

May 1	Pensacola Area Chamber of Commerce	Pensacola	6:30-9:30 p.m.

LISTING OF FLORIDA SMALL BUSINESS DEVELOPMENT-GENERATED PUBLICATIONS AND WORKSHOPS

1. An Automated System to Inform Florida Small Business of Government and Private Procurement Opportunities (INFO-BID)
2. A Handbook for the Small Independent Hotel/Motel Owner
3. Starting and Organizing a Small Business - (A Legal and Tax Guide for Small Business) (In cooperation with the American Bar Association, 2nd Edition)
4. A Recommended Loan Application Package Volume I
5. A Recommended Loan Application Package Volume II
6. Marketing Plan for the Accounting Profession
7. Steps to Starting a Business
8. How to Start a Small Business in the Central Florida Area
9. Starting a New Business in Metropolitan Jacksonville
10. All About Patents
11. Directory for Information and Assistance for Small Businesses in Florida (In cooperation with SCORE)
12. Preapplication Package - Policy Guidelines for Participating in the Florida Small Business Development Center Program
13. System of Reports
14. Florida Small Business Development Center Program Summary
15. University of West Florida Small Business Development Center Program Summary
16. Small Business "Highlights" (A Newsletter by University of West Florida)
17. A Plain-English Tax Guide for Sole Proprietors
18. Florida Innovation Program
19. Selecting a Professional Consultant
20. Spotlight on Small Business (A Newsletter by the University of North Florida Small Business Development Center)

21. SBDC Computer Financial Analysis Programs:

a. Break-Even Analysis - This program predicts the break-even point in both dollar and unit quantity terms for a proposed new small business or for an addition or change to an existing small business.

b. Capital Investment Simulation - This program uses a computer simulation to predict the expected rate of return on an investment made under conditions of uncertainty.

c. Cost Accounting Variance Program - This program determines the profitability and efficiency of a manufacturing company based upon standards, internally or externally developed.

d. Depreciation Schedule - This program compares the results of the allowable depreciation methods (pre-1981)

e. Amortization Schedule - This program generates an amortization schedule for any interest rate for any terms requested.

f. Buy vs. Lease - This program compares the net present value of buy vs. lease asset acquisition methods.

g. Cost/Benefit Analysis - This program determines the present value of cash inflows over cash outflows generated by the purchase or lease of a new capital investment.

h. Loan Analysis - By furnishing three of the listed variables, this computer program will determine the fourth. The variables are loan amount, term of loan, interest rate (APR), and loan payment.

i. Forecasting Model - This program will simulate business activity month by month for one year, or year by year for ten years. It provides all resulting financial statements, analysis, and cash flow.

j. ACRS - This program calculates depreciation expense under the Economic Recovery Act of 1981.

k. STDCST - This program calculates cost accounting standards.

l. Invest - This program determines the optimal capital investment strategy for both external and internal projects.

m. Inventory - This program allows a manufacturer to determine the optimal production schedule based on expected demand, production capacity, warehouse capacity, and the fixed and variable costs associated with production.

22. Guide to Management Consulting - A Manual for Small Business Institute Counselors - $8.05 including tax (make checks payable to The University of West Florida Bookstore).

23. TV Series - "Knowin' Where You're Goin'" - Thirteen one-half hour video-cassettes which give the viewer a comprehensive look at what is involved in starting and operating a business. This series may be ordered through the Florida Department of Education Media Center in Tallahassee, Florida. Blank tapes should be provided.

WORKSHOP MATERIALS

1. Steps to Starting a Business
2. How to Prepare a Financial Report
3. Business Organization and Taxes
4. Management Essentials of Borrowing
5. Basic Personnel Management Workshop
6. Advertising
7. Managing Finances in Small Business
8. How to Bid on Government Contracts and Others
9. How to do a Feasibility Study
10. A Practical Approach to Running a Small Business
11. Introduction to Time Management
12. Exporting Seminar

Attachment "D"

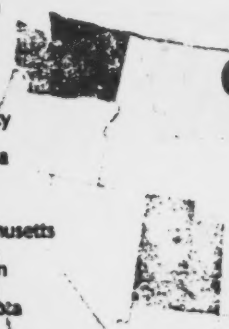
AMERICA'S SMALL BUSINESS DEVELOPMENT CENTERS

A Community Service of Participating University Systems
and Sponsored by:
United States Small Business Administration

PARTICIPATING STATES

Alabama
Arkansas
Connecticut
Delaware
Florida
Georgia
Iowa
Kansas
Kentucky
Louisiana
Maine
Massachusetts
Michigan
Minnesota
Mississippi
Missouri
Nebraska
New Jersey
Pennsylvania
Rhode Island
South Carolina
Utah
Vermont
Washington
Washington, D.C.
West Virginia
Wisconsin

STARTING AND ORGANIZING A BUSINESS



A Legal and Tax Guide for Small Businesses

(Third Edition)

Edited by: Daniel H. Kolber, J.D., LIM
Member: New York, Florida, and Virginia Bars

Subcommittee on Small Businesses of the Corporation, Banking and Business Law Committee of the Young Lawyers Division, American Bar Association

36-520 O - 84 - 3

JAMES C. SANDERS,
Administrator
United States Small Business Administration

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FOREWORD

This third edition of "Starting and Organizing a Business," provides us with an outstanding example of concrete, cooperative accomplishment. This publication has become a keystone in a statewide program that provides the small business community with legal and tax guidance. Informed decisions in these fields often mean the difference between success and failure for the small business.

As conceived by the Young Lawyers Division of the American Bar Association and in partnership with the Florida Small Business Development Centers, this effort earns our high praise. At the Small Business Administration, we are charged by Congress, "To assist, protect and promote the interest of the small business community." This publication and a program of workshops and counseling sessions is an effective embodiment of our mission and one which we find pleasure in endorsing.

During 32 years of pursuing our mission the Small Business Administration has learned that the most effective means to achieve our goals is to enlist and advocate the marriage of public and private enterprise. To this end the University of West Florida was selected, in 1977, as one of our first State Small Business Development Centers (SBDC's). This SBDC Program has achieved a parallel growth both in Florida and nationally. Today, the services offered by this fine program are available throughout the state and, by the end of 1984, similar programs will be available in 35 states.

The Small Business Subcommittee of the Young Lawyers Division of the American Bar Association exemplifies the best of public spirit and we are grateful for this contribution to the small business community.

The continuing efforts of Florida's SBDC, the Young Lawyers Division and the SBA will ensure a fruitful future, a genuine partnership of prosperity.

Sincerely,

James C. Sanders
Administrator

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INTRODUCTION AND ACKNOWLEDGEMENTS

This is the third and expanded edition of a Guide which is intended to benefit operators of small businesses. Most of the chapters which appeared in the second edition have been updated and included. In addition, six new chapters, as well as several new legal forms (for discussion purposes only) have been included. We welcome the states of Kansas, Louisiana, Michigan and Rhode Island which have recently established Small Business Development Centers. It is anticipated that during 1984 California, Illinois, Nevada, New Hampshire, New York, North Carolina, Oklahoma, Oregon, Puerto Rico, South Dakota, Tennessee, Texas and Virginia will be establishing SBDC's.

Each chapter contained in this Guide was written by an attorney who is a member of the Subcommittee on Small Businesses of the Corporation, Banking and Business Law Committee of the Young Lawyers Division, American Bar Association. The CBBL Committee functions through its subcommittees which write, analyze and comment on legislation, sponsor continuing legal education programs, and develop educational publications and materials.

Although of value to the non-specialist attorney, the Guide was written for the non-lawyer businessperson. It is not meant as a substitute for personal legal advice from an attorney. Rather, it is offered as a stimulant to explore different methods of creating and operating a business structure, raising capital, and effective utilization of available tax benefits. Commercial and tax law is in a state of constant flux and information contained herein is subject to change. Consult your attorney or local Small Business Development Center before acting.

This Guide could not have been written without the busy practitioner-authors who took the time to contribute their assigned chapters. Please see the section entitled "The Co-Authors" for a brief description of their backgrounds. Florida Representative John Cosgrove of Miami, Florida, a member of the Subcommittee, deserves thanks for his assistance in organizing the project.

Allan B. Cowart, former State Coordinator of the Florida Small Business Development Centers provided valuable assistance in encouraging the project from its inception. Jerry Widman, Associate State Coordinator of the Florida Small Business Development Centers was instrumental in publishing the second and third editions of the Guide. Gregory L. Higgins, Jr., State Coordinator of the Florida SBDC deserves thanks for his assistance and encouragement with respect to this edition.

Frank Trotta, Jr., one of the most active leaders of the ABA provided valuable advice and support. Also, special thanks to one of the most productive and dedicated members of the American Bar Association - Robert L. Geltzer. Frank, Bob and Jack Adelson, Chairman of the CBBL have been

responsible for the tremendous support of the Guide within the American Bar Association.

Once again, special thanks to Ms. Vivian K. Susenbach of the Florida SBDC staff for her help in editing, typing and preparing the manuscript. We are sorry to note that Ms. Susenbach, who has coordinated the Guide since its inception will be moving on from the Florida SBDC to rejoin the University of West Florida. Her dedication, professionalism and hard work on behalf of the small business community during her five years at the Florida SBDC exemplifies the qualities for which SBDC staff members throughout the U. S. have become known. This edition of the Guide is dedicated to these civic-minded and dedicated men and women of the staffs of Small Business Development Centers who, each day, are serving America's small business community.

Daniel H. Kolber, Editor

New York, New York
December 1984

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CHAPTER 1

THE SMALL BUSINESS: CHOOSING THE BEST OPERATING FORM

In the decision-making processes as to business organization, there is no formula for determining the "best" form of business operation. Numerous factors, which may essentially be classified as tax and non-tax factors, must be analyzed. This chapter will attempt to examine several of the common forms of business operations available, and some of the advantages and disadvantages applicable to each.

I. SOLE PROPRIETORSHIP

As one might suspect, the simplest form of business is the sole proprietorship. This is the most common form of business operation, with there being one owner and few formalities of existence. Since there is only one owner, decision-making is easy because action may be taken without the delay of a partner or board of directors meeting. A sole proprietorship is free to trade where it wishes, without complying with statutory qualification requirements. Further, a sole proprietorship is not subject to as many regulatory and reporting requirements as some other business forms, especially the corporate forms; however, a sole proprietorship is entitled to the same constitutional privileges and immunities as other forms of operation.

In the tax area, the profits of the sole proprietorship are taxed as income to the owner. Thus, individual tax rates apply, which may or may not be beneficial. There is no "double tax" on earnings here, to which corporate earnings are subject. The sole proprietorship is, of course, allowed to deduct all costs of business operation. If a sole proprietorship is sold, each asset is treated individually, and the gain or loss is capital or ordinary, depending on the nature of the asset. Where the business has operated at a loss, the owner has the benefit of an ordinary deduction. One disadvantage in this area is that even though a sole proprietor may make tax-deductible contributions to an individual retirement plan, the maximum limits are much more restricted than those accorded owners and managers of a corporation.

There, of course, are disadvantages to operating in a sole proprietorship form. The owner is subject to unlimited personal liability for the obligations of the business, which, as is understandable, is a major reason for opting for another form. The equity capital of the sole proprietorship is limited by the resources of the owner, which could prove to be a hardship. The owner of the business is the only one who can act on behalf of the business, except for one designated as an "agent," which status is subject to limitations. Further, the sole proprietorship is subject to termination upon the death or incapacity of the owner.

II. PARTNERSHIPS

In some cases, when the disadvantages of a sole proprietorship prove too burdensome, a general partnership form may be chosen. A general partnership exists when two or more persons join together in the operation and management of a business venture.

A general partnership is quite similar to a sole proprietorship, except that there is more than one person involved in the management and ownership of the business. In a general partnership, each partner has the implied authority of each other partner to bind the partnership as to any outsiders by any act within the scope of usual and ordinary activities of the business. Of course, there is a fiduciary relationship involved, which imposes good faith, loyalty and fairness in all dealings with respect to partnership affairs. Once a general partnership is formed, all partners must consent to the addition of any other partners.

Certain disadvantages to a general partnership exist. There is joint and several liability among each of the partners as to partnership obligations, and this liability extends to the personal assets of each partner. This, when coupled with the right of each partner to bind the partnership, is many times a deterrent to operating in the general partnership form. Further, the partnership terminates upon the death of a general partner, giving a partnership uncertain duration.

A partnership is a tax-reporting entity, but is not taxable itself. The income of the partnership is passed through to each of the partners. Each partner includes in his own income the partnership items of income, deductions and losses. When a partnership interest is sold, the partner realizes a capital gain or loss on the whole sale. If the business has been profitable, this is advantageous to the partner.

An off-shoot of the general partnership is the limited partnership, which is statutory in nature. A limited partnership is comprised of at least one general partner and one or more limited partners. The business of a limited partnership is carried on as a general partnership; however, a limited partner is excluded from the control and management of the partnership. The liability of a limited partner is limited to the amount of his investment in the partnership, which is an attractive feature in attempting to gain investors. A limited partner may assign his interest without the consent of the other general or limited partners, and a limited partnership is not interrupted by the death of a limited partner. A further attractive feature is that a limited partnership is not complex or expensive to organize.

III. CORPORATIONS

The final area of operation to be examined is the corporate form, of which several types exist.

There are several advantages which apply to the corporate form. One of the more important of these is the limited liability aspect, whereby a shareholder's liability is limited to the amount of his investment. This

reason alone is many times why a corporate form is chosen. A corporation is a medium for gathering substantial funds from investors for a common project. Ownership is freely and readily transferable, unless previously restricted. Corporate duration is long or perpetual, and a corporation exists as an autonomous legal entity, holding property, contracting, and the like.

Along with its advantages, certain disadvantages surround the corporate entity. Because of the limited liability concept, the availability of credit may be hindered. Management of a corporation is many times separate from ownership, and the transferability of stock eliminates the decision on who is to have an interest in the company. Minority stockholders are, in most cases, subservient to the wishes of the majority. Organizing a corporation may be expensive, complex and time-consuming, and governmental restrictions, controls and reporting requirements may be unduly burdensome. Further, if a corporation is to operate outside of its state of incorporation, it must qualify to do business in every state in which it plans to do business.

One of the more popular corporate forms is the Subchapter S corporation. (For an extensive treatment of the Subchapter S corporation, see Chapter 21.) Many sole proprietors who want the corporate advantages incorporate their business and make an election of Subchapter S status. Besides the limited liability aspect, the tax advantages are a controlling factor in electing Subchapter S status. As a simple rule of thumb, election of Subchapter S status is most advantageously made when (1) operating losses are expected, (2) substantial dividends are anticipated, or (3) the shareholders' individual tax rates are smaller than the corporate tax rates. A Subchapter S corporation is not taxable, but must file an informational return. Income is taxable pro rata to its shareholders. The disadvantage here is that it is taxable whether or not it is distributed to them. However, an attractive feature is that ordinary losses are deductible pro rata by the shareholders. Conversely, a capital loss is not passed through to the shareholders, but is carried forward against future gains. If a capital gain is realized, the shareholders are allowed pro rata capital gains. However, if a Subchapter S corporation has an operating loss in the same taxable year it realizes a capital gain, only the net capital gain in excess of the loss is treated as a capital gain. To preserve the pass-through benefits of a capital gain, a Subchapter S corporation should not realize a capital gain in a taxable year in which it has an operating loss.

The closely-held corporation is also an attractive operating form. A closely-held corporation has a small number of shareholders, and the shareholders usually control and manage the company. A simplicity of organization usually exists. However, it must be noted and remembered that because of its corporate nature, the closely-held corporation must observe all formalities of corporate procedure, it must be provided with adequate capitalization, and it must be maintained as an independent financial unit and not the alter ego of its shareholders.

Because a shareholder of a closely-held corporation is usually an employee of the corporation, the shareholder qualifies for certain tax benefits. A corporation may deduct as an expense contributions to a qualified pension or profit-sharing plan, and such contributions would not be currently

taxable to the employee. These contributions may be profitably invested tax-free until they are withdrawn. Further, employees may receive tax-free health and accident benefits, group insurance plans, certain death-benefit payments to a surviving spouse, and exclusions for all or part of salary contribution plans during illness or incapacitation, and all of these are deductible by the corporate employer.

Since many of the benefits of a closely-held corporation apply to publicly-held corporations, an examination of publicly-held corporations will not be undertaken.

CONCLUSION

As was stated at the outset, there is no concrete method of determining what form of business operation is the "best" form. All factors surrounding the business must be examined in order for an informed decision to be reached. If many of the factors that were outlined in this chapter are analyzed and if the advantages and disadvantages are weighed, an informed decision can be reached.

CHAPTER 2

INCORPORATING A BUSINESS

Having made the decision to incorporate, the incorporator must comply with the state statutory scheme for filing the articles of incorporation (also know as the certificate of incorporation). A lawyer should be consulted to draft the articles and arrange for filing because each state's law is constantly changing as a result of statute amendments and court decisions. At the end of this chapter is a sample certificate of incorporation which is modeled after the articles of incorporation required under the Florida General Corporation Act. It is presented only as a guide in communicating with the incorporator's attorney.

Although state corporation laws are similar in many respects, each state's laws in this area are unique. The following discussion of the information which must be included in the articles of incorporation is a general overview. Your own state statutes should be consulted.

All states require the articles of incorporation to state the corporation's name which must contain the word "corporation," "incorporation," or other word or abbreviation which indicates it is a corporation. The name cannot be similar to any other corporation doing business in the state. Most states allow the reservation of a name for a period of 120 days.

The period of the corporation's duration must be stated in the articles. For most corporations the duration is "perpetual."

An area of corporation law which varies from state to state is the requirement for setting forth the purpose for which the corporation is organized. Some states require an explicit statement of purpose. No "catch-all" broad description is allowed. Business conduct not within the purposes enunciated can be enjoined as ultra vires. Florida, Delaware, and Virginia, on the other hand, make it easier for the incorporator by allowing a catch-all purpose provision such as "to engage in the transaction of any or all lawful business for which corporations may be incorporated under the provisions of the (particular state's general corporation act)."

The aggregate number of shares which the corporation will have the authority to issue is another required article. Keep in mind the distinction between authorized shares and issued shares. Issued shares are issued by the Board of Directors up to the amount of authorized shares as stated in the articles of incorporation.

Provisions granting preemptive rights may be stated in the articles in many states. Preemptive rights are the rights of a shareholder to maintain his proportionate interest in the corporation by having the right to acquire

shares issued in future offerings by the corporation. Some states give these rights by law unless excluded by the articles of incorporation. (Florida amended its statute a few years ago to deny shareholders preemptive rights except to the extent provided in the articles of incorporation.)

The articles may regulate matters relevant to the internal affairs of the corporation by providing for such matters as dividend rights, voting rights for certain classes of stock, quorum for meetings, action by written consent without a meeting, the establishment of committees, denial of issuance of options or warrants, cumulative voting, procedures to amend the by-laws, etc.

Cumulative voting gives the shareholder the right to have as many votes as his shares multiplied by the number of directors to be elected. He can allocate his votes among the candidates in any way he desires, including in some cases, by casting fractional votes. Florida is one of several states which allows provisions authorizing cumulative voting to be included in the articles of incorporation.

Unless otherwise stated in the articles, most states require a majority of the shares entitled to vote at a meeting, represented in person or proxy, to constitute a quorum. Florida is typical of many states which allow modification of quorum requirements but in no event may the quorum requirements be less than one-third of the shares entitled to vote at a meeting. The articles of incorporation may also set similar quorum requirements for directors meetings.

Unless otherwise stated in the articles, most states, including Florida, Delaware, New York, and Virginia, allow action to be taken by the shareholders or directors by written consent in lieu of a formally held meeting. Recent years have seen the passage of state statutes allowing meetings to be held by telephone conference calls.

Unless reserved to the shareholders in the articles of incorporation, the board of directors of the corporation has the power to adopt, amend, or repeal the by-laws. See Chapter 3 for information regarding by-laws.

The number of directors must be stated in the articles. Most states, including Florida, allow one director, who could be the incorporator as well (and, of course, sole shareholder).

The incorporator must sign the articles (witnessed by a notary). The incorporator cannot be a minor but there are no citizenship or residency requirements.

The articles of incorporation may be amended as often as desired. The most common amendments are name changes and increases in authorization of shares.

SAMPLE ARTICLES OF INCORPORATION

STATE OF (SUNSHINE)

ARTICLES OF INCORPORATION

OF

(ORANGE CORPORATION)

THE UNDERSIGNED, ACTING AS INCORPORATOR OF A CORPORATION UNDER THE (SUNSHINE CORPORATION ACT), ADOPTS THE FOLLOWING ARTICLES OF INCORPORATION:

FIRST: THE NAME OF THE CORPORATION IS (ORANGE CORPORATION).

SECOND: THE PERIOD OF ITS DURATION IS (PERPETUAL).

THIRD: THE DATE AND TIME OF THE COMMENCEMENT OF THE CORPORATE EXISTENCE IF OTHER THAN THE FILING OF ARTICLES BY THE DEPARTMENT OF STATE IS ( ).

FOURTH: THE PURPOSES FOR WHICH THE CORPORATION IS ORGANIZED ARE (TO ENGAGE IN THE TRANSACTION OF ANY OR ALL LAWFUL BUSINESS FOR WHICH CORPORATIONS MAY BE INCORPORATED UNDER THE PROVISIONS OF THE SUNSHINE GENERAL CORPORATION ACT.)

FIFTH: THE AGGREGATE NUMBER OF SHARES WHICH THE CORPORATION SHALL HAVE AUTHORITY TO ISSUE IS (100 SHARES, PAR VALUE, $.01 PER SHARE).

SIXTH: PROVISIONS GRANTING PREEMPTIVE RIGHTS ARE: ( ).

SEVENTH: PROVISIONS FOR THE REGULATION OF THE INTERNAL AFFAIRS OF THE CORPORATION ARE: ( ).

EIGHTH: THE STREET ADDRESS OF THE INITIAL REGISTERED OFFICE OF THE CORPORATION IS (ORANGE CORPORATION, 4444 ALTARA AVENUE, CITY OF CORAL GABLES, SUNSHINE 33146) AND THE NAME OF ITS INITIAL REGISTERED AGENT AT SUCH ADDRESS IS (NATALIE ORANGE).

NINTH: THE NUMBER OF DIRECTORS CONSTITUTING THE INITIAL BOARD OF DIRECTORS IS THREE (3), AND THE NAMES AND ADDRESSES OF THE PERSONS WHO ARE TO SERVE AS DIRECTORS UNTIL THE FIRST ANNUAL MEETING OF SHAREHOLDERS OR UNTIL THEIR SUCCESSORS ARE ELCTED AND SHALL QUALIFY ARE:

(LESLEY ORANGE, 4444 ALTARA AVE., ETC.
ABBY ORANGE, 4444 ALTARA AVE., ETC.
MARCIA ORANGE, 4444 ALTARA AVE., ETC.)

Chapter 3

CORPORATE BY-LAWS: SETTING THE GROUND RULES

The filing of the articles (or certificate) of incorporation with the Secretary of State breathes life into the corporation as discussed in the previous chapter. Before the corporation can operate pursuant to its business purposes, it must adopt a set of by-laws which are analogous to a constitution for a governing body. While the articles of incorporation are very short and usually set forth only the most basic features of the corporation (e.g., name, purpose and capitalization), the by-laws provide more detailed rules on how to run the corporation.

After the incorporator files the articles of incorporation, he or she will usually then elect the board of directors who, in turn, will adopt the by-laws.

At the end of this chapter is a sample set of by-laws which are presented only as a guide in communicating with the corporate attorney who will prepare the actual by-laws. Each state's laws are different with respect to what is required, or permitted, in a corporation's by-laws.

Generally, by-laws should include, at a minimum, the following types of provisions.

The by-laws should explain the mechanics of issuing stock in the corporation. These provisions should explain which officer signs the stock certificates, whether fractional shares can be issued, and how shares are transferred.

Stockholder meetings are governed by the by-laws. The record date for stockholders should be determined in advance of any meeting, pursuant to the by-laws, in order to determine which stockholders are entitled to vote. The by-laws should provide for the time and place of the meeting as well as who has the right to call the meeting. Usually the by-laws will provide specific rules as to the timing and content of the written notice of the meeting (as well as how such notice may be waived).

State law usually gives a stockholder the right to inspect the stockholder list at, or near the time of, the stockholders meeting and the implementation of these requirements should be set forth in the by-laws.

Stockholders may authorize other persons to act for him or her at the meeting by proxy and by-law provisions should cover the mechanics of this procedure.

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TENTH: THE NAME AND ADDRESS OF THE INCORPORATOR IS (JODY ORANGE, 4444 ALTARA AVE., ETC.).

DATED (January 15, 1984).

/s /_____
(JODY ORANGE),
INCORPORATOR

STATE OF (SUNSHINE)

COUNTY OF (DADE)

THE FOREGOING INSTRUMENT WAS ACKNOWLEDGED BEFORE ME THIS (15TH) DAY OF (JANUARY, 1984), BY (JODY ORANGE, INCORPORATOR) OF (ORANGE CORPORATION).

MY COMMISSION EXPIRES ( ).

_____
NOTARY PUBLIC

State law will usually set a minimum quorum requirement at stockholders meetings and the by-laws may reflect that, or, as allowed in most states, may increase the quorum requirement to a specified amount.

The by-laws will establish the rules of conducting and voting at the meeting. Procedures on selecting inspectors of elections should be included.

Finally, with respect to stockholder meetings, most corporations include in their by-laws provisions allowing for stockholder action without the necessity of holding an actual meeting.

The next major area of governance included in the by-laws are provisions relating to the directors of the corporation. These provisions will detail the directors' functions, qualifications, number (usually a range such as "at least three but no more than seven"), election and term of office. There should also be provisions relating to the removal of directors, e.g. whether a director may be removed with or without cause by the stockholders or other directors.

Directors meetings are closely regulated by the by-laws and provisions similar to those relating to stockholders meetings should be included.

A provision should also be included allowing the board of directors the authority to establish committees of the board and to determine the functions of these committees.

A third major area of corporate operations governed by the by-laws are matters relating to officers. These provisions specify the titles of the officers, their powers and duties, term of office, how elected (by the directors) and whether they may be removed for or without cause.

Other basic provisions included in the by-laws include the adoption of the corporate seal and the fixing of the corporation's fiscal year.

Finally, the by-laws should provide for the authority of the directors to amend the by-laws or to adopt new ones.

SAMPLE BY-LAWS

By-Laws

of

Orange Corporation

(A _____ Corporation)

ARTICLE I

STOCKHOLDERS

1. CERTIFICATES REPRESENTING STOCK. Every holder of stock in the corporation shall be entitled to have a certificate signed by, or in the name of, the corporation by the Chairman or Vice-Chairman of the Board of Directors, if any, or by the President or a Vice-President and by the Treasurer or an Assistant Treasurer or the Secretary or an Assistant Secretary of the corporation certifying the number of shares owned by him in the corporation. If such certificate is countersigned by a transfer agent other than the corporation or its employee or by a registrar other than the corporation or its employee, the signatures of the officers of the corporation may be facsimiles. In case any officer who has signed or whose facsimile signature has been placed upon a certificate shall have ceased to be such officer before such certificate is issued, it may be issued by the corporation with the same effect as if he were such officer at the date of issue.

Whenever the corporation shall be authorized to issue more than one class of stock or more than one series of any class of stock, and whenever the corporation shall issue any shares of its stock as partly paid stock, the certificates representing shares of any such class or series or of any such partly paid stock shall set forth thereon the statements prescribed by the (General Corporation Law). Any restrictions on the transfer or registration of transfer of any shares of stock of any class or series shall be noted conspicuously on the certificate representing such shares.

The corporation may issue a new certificate of stock in place of any certificate theretofore issued by it, alleged to have been lost, stolen, or destroyed, and the Board of Directors may require the owner of any lost, stolen, or destroyed certificate, or his legal representative, to give the corporation a bond sufficient to indemnify the corporation against any claim that may be made against it on account of the alleged loss, theft, or destruction of any such certificate or the issuance of any such new certificate.

2. FRACTIONAL SHARE INTERESTS. The corporation may, but shall not be required to, issue fractions of a share of stock or it may pay in cash the fair value of fractions of a share of stock as of the time when those entitled to receive such fractions are determined or it may issue scrip or fractional warrants in registered or bearer form over the manual or facsimile signature of an officer of the corporation or of its agent, exchangeable as therein provided for full shares of stock, but such scrip or fractional warrants shall not entitle the holder to any rights of a stockholder except as the Board of Directors shall provide. Such scrip or fractional warrants may be issued subject to the condition that the same shall become void if not exchanged for certificates representing full shares of stock before a specified date, or subject to the condition that the shares of stock for which such scrip or fractional warrants are exchangeable may be sold by the corporation and the proceeds thereof distributed to the holders of such scrip or fractional warrants, or subject to any other conditions which the Board of Directors may determine.

3. STOCK TRANSFERS. Upon compliance with provisions restricting the transfer or registration of transfer of shares of stock, if any, transfers or registration of transfers of shares of stock of the corporation shall be made only on the stock ledger of the corporation by the registered holder thereof, or by his attorney thereunto authorized by power of attorney duly executed and filed with the Secretary of the corporation or with a transfer agent or a registrar, if any, and on surrender of the certificate or certificates for such shares of stock properly endorsed and the payment of all taxes due thereon.

4. RECORD DATE FOR STOCKHOLDER. For the purpose of determining the stockholders entitled to notice of or to vote at any meeting of stockholders or any adjournment thereof, or to express consent to or dissent from any corporate action in writing without a meeting, or for the purpose of determining stockholders entitled to receive payment of any dividend or other distribution or the allotment of any rights, or entitled to exercise any rights in respect of any change, conversion, or exchange of stock, or for the purpose of any other lawful action, the directors may fix, in advance, a date as the record date for any such determination of stockholders. Such date shall not be more than sixty days nor less than ten days before the date of such meeting, nor more than sixty days prior to any other action. If no record date is fixed, the record date for the determination of stockholders entitled to notice of or to vote at a meeting of stockholders shall be at the close of business on the day next preceding the day on which notice is given, or, if notice is waived, at the close of business on the day next preceding the day on which the meeting is held; the record date for determining stockholders for any other purpose shall be at the close of business on the day on which the Board of Directors adopts the resolution relating thereto. When a determination of stockholders of record entitled to notice of or to vote at any meeting of stockholders has been made as provided in this paragraph, such determination shall apply to any adjournment thereof; provided, however, that the Board of Directors may fix a new record date for the adjourned meeting.

5. MEANING OF CERTAIN TERMS. As used herein in respect of the right to notice of a meeting of stockholders or a waiver thereof or to participate or vote thereat or to consent or dissent in writing in lieu of a meeting, as the case may be, the term "share" or "shares" or "share of stock" or "shares of stock" or "stockholder" or "stockholders" refers to an outstanding share or shares of stock and to a holder or holders of record of outstanding shares of stock when the corporation is authorized to issue only one class of shares of stock, and said reference is also intended to include any outstanding share or shares of stock and any holder or holders of record of outstanding shares of stock of any class upon which or upon whom the certificate of incorporation confers such rights where there are two or more classes or series of shares of stock or upon which or upon whom the (General Corporation Law) confers such rights notwithstanding that the certificate of incorporation may provide for more than one class or series of shares of stock, one or more of which are limited or denied such rights thereunder; provided, however, that no such right shall vest in the event of an increase or a decrease in the authorized number of shares of stock of any class or series which is otherwise denied voting rights under the provisions of the certificate of incorporation.

6. STOCKHOLDER MEETINGS.

- TIME. The annual meeting shall be held on the date and at the time fixed, from time to time, by the directors, provided, that the first annual meeting shall be held on a date within thirteen months after the organization of the corporation, and each successive annual meeting shall be held on a date within thirteen months after the date of the preceding annual meeting. A special meeting shall be held on the date and at the time fixed by the directors.

- PLACE. Annual meetings and special meetings shall be held at such place, within or without the State of _____, as the directors may, from time to time, fix. Whenever the directors shall fail to fix such place, the meeting shall be held at the registered office of the corporation in the State of _____.

- CALL. Annual meetings and special meetings may be called by the directors or by any officer instructed by the directors to call the meeting.

- NOTICE OR WAIVER OF NOTICE. Written notice of all meetings shall be given, stating the place, date, and hour of the meeting and stating the place within the city or other municipality or community at which the list of stockholders of the corporation may be examined. The notice of an annual meeting shall state that the meeting is called for the election of directors and for the transaction of other business which may properly come before the meeting, and shall, (if any other action which could be taken at a special meeting is to be taken at such annual meeting) state the purpose or purposes. The notice of a special meeting shall in all instances state the purpose or purposes for which the meeting is called. If any action is proposed to be taken which would, if taken, entitle stockholders to recieve payment for their shares of stock, the notice shall include a statement of that purpose and to that effect. Except as otherwise provided by the (General Corporation Law) a copy of the notice of any meeting shall be given, personally or by mail, not

less than ten days nor more than fifty days before the date of the meeting, unless the lapse of the prescribed period of time shall have been waived, and directed to each stockholder at his record address or at such other address which he may have furnished by request in writing to the Secretary of the corporation. Notice by mail shall be deemed to be given when deposited, with postage thereon prepaid, in the United States mail. If a meeting is adjourned to another time, not more than thirty days hence, and/or to another place, and if an announcement of the adjourned time and/or place is made at the meeting, it shall not be necessary to give notice of the adjourned meeting unless the directors, after adjournment, fix a new record date for the adjourned meeting. Notice need not be given to any stockholder who submits a written waiver of notice by him before or after the time stated therein. Attendance of a person at a meeting of stockholders shall consitute a waiver of notice of such meeting, except when the stockholder attends a meeting for the express purpose of objecting, at the beginning of the meeting, to the transaction of any business because the meeting is not lawfully called or convened. Neither the business to be transacted at, nor the purpose of, any regular or special meeting of the stockholders need be specified in any written waiver of notice.

- STOCKHOLDER LIST. The officer who has charge of the stock ledger of the corporation shall prepare and make, at least ten days before every meeting of stockholders, a complete list of the stockholders, arranged in alphabetical order, and showing the address of each stockholder and the number of shares registered in the name of each stockholder. Such list shall be open to the examination of any stockholder, for any purpose germane to the meeting, during ordinary business hours, for a period of at least ten days prior to the meeting, either at a place within the city or other municipality or community where the meeting is to be held, which place shall be specified in the notice of the meeting, or if not so specified, at the place where the meeting is to be held. The list shall also be produced and kept at the time and place where the meeting is to be held. The list shall also be produced and kept at the time and place of the meeting during the whole time thereof, and may be inspected by any stockholder who is present. The stock ledger shall be the only evidence as to who are the stockholders entitled to examine the stock ledger, the list required by this section or the books of the corporation, or to vote at any meeting of stockholders.

- CONDUCT OF MEETING. Meetings of the stockholders shall be presided over by one of the following officers in the order of seniority and if present and acting - the Chairman of the Board, if any, the Vice-Chairman of the Board, if any, the President, a Vice-President, or, if none of the foregoing is in office and present and acting, by a chairman to be chosen by the stockholders. The Secretary of the corporation, or in his absence, an Assistant Secretary, shall act as secretary of every meeting, but if neither the Secretary nor an Assistant Secretary is present the Chairman of the meeting shall appoint a secretary of the meeting.

- PROXY REPRESENTATION. Every stockholder may authorize another person or persons to act for him by proxy in all matters in which a stockholder is entitled to participate, whether by waiving notice of any meeting, voting or participating at a meeting, or expressing consent or dissent without a meeting. Every proxy must be signed by the stockholder or by his attorney-in-

fact. No proxy shall be voted or acted upon after three years from its date unless such proxy provides for a longer period. A duly executed proxy shall be irrevocable if it states that it is irrevocable and, if, and only as long as, it is coupled with an interest sufficient in law to support an irrevocable power. A proxy may be made irrevocable regardless of whether the interest with which it is coupled is an interest in the stock itself or an interest in the corporation generally.

- INSPECTORS AND JUDGES. The directors, in advance of any meeting, may, but need not, appoint one or more inspectors of election or judges of the vote, as the case may be, to act at the meeting or any adjournment thereof. If an inspector or inspectors or judge or judges are not appointed, the person presiding at the meeting may, but need not, appoint one or more inspectors or judges. In case any person who may be appointed as an inspector or judge fails to appear or act, the vacancy may be filled by appointment made by the directors in advance of the meeting or at the meeting by the person presiding thereat. Each inspector or judge, if any, before entering upon the discharge of his duties, shall take and sign an oath faithfully to execute the duties of inspector or judge at such meeting with strict impartiality and according to the best of his ability. The inspectors or judges, if any, shall determine the number of shares of stock outstanding and the voting power of each, the shares of stock represented at the meeting, the existence of a quorum, the validity and effect of proxies, and shall recieve votes, ballots or consents, hear and determine all challenges and questions arising in connection with the right to vote, count and tabulate all votes, ballots or consents, determine the result, and do such acts as are proper to conduct the election or vote with fairness to all stockholders. On request of the person presiding at the meeting, the inspector or inspectors or judge or judges, if any, shall make a report in writing of any challenges, question or matter determined by him or them and execute a certificate of any fact found by him or them.

- QUORUM. The holders of a majority of the outstanding shares of stock shall consitute a quorum at a meeting of stockholders for the transaction of any business. The stockholders present may adjourn the meeting despite the absence of a quorum.

- VOTING. Each share of stock shall entitle the holder thereof to one vote. In the election of directors, a plurality of the votes cast shall elect. Any other action shall be authorized by a majority of the votes cast except where the (General Corporation Law) prescribes a different percentage of votes and/or a different excercise of voting power. In the election of directors, voting need not be by ballot. Voting by ballot shall not be required for any other corporate action except as otherwise provided by the (General Corporation Law).

7. STOCKHOLDER ACTION WITHOUT MEETINGS. Whenever the vote of stockholders at a meeting thereof is required or permitted to be taken for or in connection with any corporate action, the meeting and vote of stockholders may be dispensed with if all of the stockholders who would have been entitled to vote upon the action if such meeting were held shall consent in writing to such corporate action being taken; or if less than all of said stockholders, but not less than those having at least the minimum voting power required to

take corporate action under the provisions of the (General Corporation Law), shall consent in writing to such corporate action; provided that prompt notice be given to all stockholders of the taking of such action without a meeting and by less than unanimous written consent.

ARTICLE II

DIRECTORS

1. FUNCTIONS AND DEFINITION. The business of the corporation shall be managed by the Board of Directors of the corporation. The use of the phrase "whole board" herein refers to the total number of directors which the corporation would have if there were no vacancies.

2. QUALIFICATIONS AND NUMBER. A director need not be a stockholder, a citizen of the United States, or a resident of the State of _____. The initial Board of Directors shall consist of ____ persons. Thereafter the number of directors constituting the whole board shall be at least three, except that, where all the shares of stock of the corporation are owned beneficially and of record by less than three stockholders, the number of directors may be less than three but not less than the number of such stockholders. Subject to the foregoing limitation and except for the first Board of Directors, such number may be fixed from time to time by action of the stockholders or of the directors, or, if the number is not fixed, the number shall be ____. The number of directors may be increased or decreased by action of the stockholders or of the directors.

3. ELECTION AND TERM. The first Board of Directors, unless the members thereof shall have been named in the certificate of incorporation, shall be elected by the incorporator or incorporators and shall hold office until the first annual meeting of stockholders and until their successors have been elected and qualified or until their earlier resignation or removal. Thereafter, directors who are elected at an annual meeting of stockholders, and directors who are elected in the interim to fill vacancies and newly created directorships, shall hold office until the next annual meeting of stockholders and until their successors have been elected and qualified or until their earlier resignation or removal. In the interim between annual meetings of stockholders or of special meetings of stockholders called for the election of directors and/or for the removal of one or more directors and for the filling of any vacancy in that connection, newly created directorships and any vacancies in the Board od Directors, including vacancies resulting from the removal of directors for cause or without cause, may be filled by the vote of a majority of the remaining directors then in office, although less than a quorum, or by the sole remaining director.

4. MEETINGS:

- TIME. Meetings shall be held at such time as the Board shall fix, except that the first meeting of a newly elected Board shall be held as soon after its election as the directors may conveniently assemble.

- PLACE. Meetings shall be held at such place within or without the State of _____ as shall be fixed by the Board.

- Call. No call shall be required for regular meetings for which the time and place have been fixed. Special meetings may be called by or at the direction of the Chairman of the Board, if any, the Vice-Chairman of the Board, if any, of the President, or of a majority of the directors in office.

- NOTICE OR ACTUAL OR CONSTRUCTIVE WAIVER. No notice shall be required for regular meetings for which the time and place have been fixed. Written, oral, or any other mode of notice of the time and place shall be given for special meetings in sufficient time for the convenient assembly of the directors thereat. The notice of any meeting need not specify the purpose of the meeting. Any requirement of furnishing a notice shall be waived by any director who signs a written waiver of such notice before or after the time stated therein.

- QUORUM AND ACTION. A majority of the whole Board shall constitute a quorum except when a vacancy or vacancies prevents such majority, whereupon a majority of the directors in office shall constitute a quorum, provided, that such majority shall constitute at least one-third of the whole Board. A majority of the directors present, whether or not a quorum is present, may adjourn a meeting to another time and place. Except as herein otherwise provided, and except as otherwise provided by the (General Corporation Law), the act of the Board shall be the act by vote of a majority of the directors present. The quorum and voting provisions herein stated shall not be construed as conflicting with any provisions of the (General Corporatien Law) and these By-Laws which govern a meeting of directors held to fill vacancies and newly created directorships in the Board.

- CHAIRMAN OF THE MEETING. The Chairman of the Board, if any and if present and acting, shall preside at all meetings. Otherwise, the Vice-Chairman of the Board, if any and if present and acting, or the President, if present and acting, or any other director chosen by the Board, shall preside.

5. REMOVAL OF DIRECTORS. Any or all of the directors may be removed for cause or without cause by the stockholders. One or more of the directors may be removed for cause by the Board of Directors.

6. COMMITTEES. The Board of Directors may, by resolution passed by a majority of the whole Board, designate one or more committees, each committee to consist of two or more of the directors of the corporation. The Board may designate one or more directors as alternate members of any committee, who may replace any absent or disqualified member at any meeting of the committee. Any such committee, to the extent provided in the resolution of the Board, shall have and may exercise the powers of the Board of Directors in the management of the business and affairs of the corporation, and may authorize the seal of the corporation to be affixed to all papers which may require it. In the absence or disqualification of any member of any such committee or committees, the member or members thereof present at any meeting and not disqualified from voting, whether or not he or they constitute a quorum, may

unanimously appoint another member of the Board of Directors to act at the meeting in the place of any such absent or disqualified member.

7. ACTION IN WRITING. Any action required or permitted to be taken at any meeting of the Board of Directors or any committee thereof may be taken without a meeting if all members of the Board or committee, as the case may be, consent thereto in writing, and the writing or writings are filed with the minutes of proceedings of the Board or committee.

ARTICLE III

OFFICERS

The directors shall elect a President, a Secretary, and a Teasurer, and may elect a Chairman of the Board of Directors, a Vice-Chairman thereof, and one or more Vice-Presidents, Assistant Secretaries, and Assistant Treasurers, and may elect or appoint such other officers and agents as are desired. The President may but need not be a director.

Unless otherwise provided in the resolution of election or appointments, each officer shall hold office until the meeting of the Board of Directors following the next annual meeting of stockholders and until his successor has been elected and quaiified.

Officers shall have the powers and duties defined in the resolutions appointing them; provided, that the Secretary shall record all proceedings of the meetings or of the written actions of the stockholders and of the directors, and any committee thereof, in a book to be kept for that purpose.

The Board of Directors may remove any officer for cause or without cause.

ARTICLE IV

CORPORATE SEAL

The corporate seal shall be in such form as the Board of Directors shall prescribe.

ARTICLE V

FISCAL YEAR

The fiscal year of the corporation shall be fixed, and shall be subject to change, by the Board of Directors.

ARTICLE VI

CONTROL OVER BY-LAWS

The power to amend, alter, and repeal these By-Laws and to adopt new By-Laws shall be vested in the Board of Directors; provided, that the Board of Directors may delegate such power, in whole or in part, to the stockholders; and provided, further, that any By-Laws, other than an initial By-Law, which provides for the election of directors by classes for staggered terms shall be adopted by the stockholder.

CHAPTER 4

TAX ASPECTS TO AN ACQUISITION OR SALE OF A BUSINESS

Purchasers and sellers of businesses frequently fail to take advantage of the applicable tax laws in structuring their purchase or sale of a business. The obvious end result is the incurring of a greater tax liability than was necessary.

Seller's Viewpoint

In the event that the parties desire to structure the payout to last more than one year, the seller may be able to apply the installment sales law, thereby including as income only that amount actually received that year, not the entire purchase price.

Also, no matter how the sale is structured, the seller should be careful to consider his holding period for the assets to insure that he receives long term capital gain treatement.

As discussed in Chapter 1, there are three major forms under which the business enterprise could have been organized. First, it could have been a sole proprietorship; second, it could have been a partnership; and, finally, it could have been a corporation. When a person sells a sole proprietorship, it is not viewed as a sale of a separate entity or business but as a sale of the individual assets of the business. To receive capital gains, the seller should allocate most of the purchase price to the capital assets and goodwill. The purchaser, on the other hand, desires that most of the purchase price be allocated towards accounts receivable and inventory, thereby creating a higher cost for those items and reducing his eventual ordinary income, but increasing the seller's ordinary income.

The seller of a sole proprietorship should consider the holding period of the capital assets involved. Also, it may be advisable for the seller of a sole proprietorship to incorporate his business a year or more before he intends to sell to receive more favorable capital gains treatment.

The sale of the assets of the partnership may also be treated individually. Still, the partners may be able to treat the sale of their interest as the sale of a capital asset, thereby expanding capital gains treatment. It is important that the sale be structured so that it looks like a sale of partnership interests, not a sale of the assets followed by a liquidation. Still, even the sale of the partnership interest will cause certain assets to receive ordinary income treatment, namely, accounts receivable that have not been realized and inventory which has appreciated substantialiy in value (i.e., more than 120% of the cost and the inventory value exceeds 10% of the fair market value of all partnership property other

than money). Here, too, it may be advisable for it to incorporate more than one year prior to the time that the partners intend to sell.

In the event the business is run as a corporation, then the seller has two choices: either to sell the stock of the corporation or to sell the assets of the corporation and, then, liquidate the corporation. In either event, the applicable holding period is that for the stock, not the underlying assets. If the seller sells the stock, then he treats the entire gain as a capital one.

There are a variety of methods by which the seller may sell the assets and liquidate. If he exchanges the assets for his stock, he will receive capital gains treatment because of the complete redemption of the stock. On the corporate level, there will be no gain or loss from such liquidation (even of inventory) except for liquidation of receivables and recapture of depreciation on personal and real property. A potential pitfall arises if the stockholders have sold the assets of the corporation and then liquidate. Such action could result in a tax on the corporate level from the sale and a tax on the shareholders' level from the redemption of the stock.

Congress enacted Section 337 of the Internal Revenue Code to enable shareholders to avoid such a pitfall. If followed, no gain or loss will occur at the corporate level from the sale of the assets of the business. Under Section 337, the shareholders must adopt a plan of complete liquidation and distribute the assets of the corporation within twelve months of the adoption of the plan. The corporation may enter a contract prior to the adoption of the plan, but may not pass title or possession of the assets.

Section 333 of the Code provides an alternative method of liquidation with different tax consequences. To the extent the corporation has earnings or profits such a distribution would result in dividend treatment (i.e., ordinary income). If stock, money or securities are distributed in the liquidation, then to that extent, the shareholders will recognize capital gains treatment. No gain or loss is recognized on all other distribution of assets.

In order to comply with Section 333, 80% of the shareholders must give their written consent within 30 days of the adoption of the plan. Complete redemption of all stock after adoption of the plan must occur within some one month period, not necessarily the same month in which the plan has been adopted.

The sale can be structured with no taxable gain to the selling shareholder. One method is an exchange of stock for common stock of the acquiring corporation. The acquiring corporation must acquire 80% or more of common stock and 80% or more of all other stock. Another method is where there is a merger or consolidation of the two corporations. A merger is where one of the corporations survives. A consolidation, on the other hand, is where neither corporation survives, but both corporations are combined to form a third corporation. A third method is where the assets of the acquired corporation are purchased with the common stock of the acquiring corporation.

Such tax free reorganization may be useful where the parties desire to combine two or more enterprises and thereby become partners.

Buyer's Viewpoint

There are fewer tax options available to the buyer. First, as stated earlier, the more the price is allocated to inventory and receivables, the lower the ordinary income the buyer will eventually receive. Also, it may be advantageous to allocate more of the remainder to the fixed assets because of depreciation. On the other hand, some states' sales tax may not cover that portion of the price paid for goodwill. Since good will is not depreciable, the buyer has the choice of paying less tax now or getting greater tax benefits later on.

The buyer must now decide what form to operate the business. The potential tax consequences depend upon whether the business is operated to achieve profit or tax shelter other income. If the business is designed as a tax shelter, then the buyer would desire to operate it as a sole proprietorship or partnership to take personal advantage of tax losses. If operated for a profit and the partners are in a high enough tax bracket, it may pay to incorporate to retain the earnings in the corporation at its lower tax rate. (The potential pitfalls to this approach are a penalty on unreasonable accumulated earnings and treatment as a personal holding company. A discussion of such pitfalls is beyond the scope of this Guide.) If the taxpayers are in a lower tax bracket, but desire the advantage of limited liability, then they may desire to incorporate and elect Subchapter S treatment, thereby being taxed essentially as a partnership (see Chapter 21).

In the event the purchased organization form is different than the desired form, the buyers may usually make the desired change without adverse tax consequences.

If the buyer purchased a corporation but desires a partnership or sole proprietorship, the buyer may liquidate usually without a gain since his cost of the stock would equal the fair market value of the assets. Still, there may be gain if there was a distribution of receivables or recapture of depreciation. If the buyers purchase the assets only or the business was run as a sole proprietorship or partnership and the buyers desire to incorporate, they may transfer the assets to a corporation without recognizing a gain or loss on the transfer. The buyers' cost of their stock in the corporation would be their cost of the assets. The corporation's cost for the assets will be the cost at which the buyers purchased them. Where there are substantial depreciable assets, the parties may desire to only transfer the non-depreciable assets to the corporation and lease the depreciable assets to the corporation, thereby personally benefiting from the depreciation.

In the event the buyers purchased stock but really desired that the assets be transferred to their corporation, they may do so. First, they must buy 80% of the voting stock and 80% of all other stock within twelve months. Second, they must liquidate the corporation not more than two years after they made the purchase. The cost of the individual assets will be determined based

upon the proportion its fair market value bears to the fair market value of all the assets times total purchase price.

CONCLUSION

This chapter was not intended to be a comprehensive review of all the tax consequences on a sale of a business, but only an indication that proper tax planning will be beneficial in structuring the sale of a business.

CHAPTER 5

PARTNERSHIP AND SHAREHOLDERS' AGREEMENTS

When two or more people get together to form a business operation, they have visions of a highly successful operation, usually not contemplating the pitfalls. A shareholders' or partnership agreement is an excellent mechanism for bringing some of the potential problems among participants into focus and providing guidelines to resolve them, thereby avoiding costly litigation. While this chapter does not cover every possible provision that can be placed in a shareholders' agreement, hopefully it will demonstrate the need for such agreements any time there is more than one owner of a business.

A partnership or shareholders' agreement may provide for the initial capitalization of the business, thereby turning what is usually a moral obligation into a legal one. The best ideas in the world never get off the ground without adequate funds for the initial operation. Since there is no way to adequately predict the future financial needs of the enterprise, this provision is a one-shot provision rather than a continuing obligation.

The shareholders' or partnership agreement should also cover the method of management of the business enterprise. If the enterprise is a corporation the provision should cover the election of directors. Since most small business corporations are, in effect, incorporated partnerships, if permitted by state law the parties may desire that the shareholders rather than directors manage the business. The agreement may limit or enlarge the normal powers of partners, directors or officers. Such a clause will not affect third persons who deal with the enterprise without knowledge of this clause. The agreement may also provide for non-competition between the owners and the enterprise. It may provide the method for computing salaries and bonuses. The agreement should provide the method of continuing the operation in the event one of the owners becomes so disabled that he is unable to help manage the business.

The agreement may also provide for arbitration of disputes among the participants. Arbitration is a much simpler method of resolving disputes between parties without having to resort to expensive litigation. Originally, most arbitration agreements were viewed with skepticism by the courts since the parties were giving up their right to a trial. The present trend is to permit more and more disputes to be covered by an arbitration agreement, therefore, the participants should decide whether or not certain disputes or all disputes concerning the enterprise should be arbitrated.

One of the most important provisions in the agreement is a restriction on the participants' right to sell their interest to third parties. The participants chose each other because of their personal qualities and, to permit one to sell to a stranger would defeat their intent. On the other

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hand, it is unfair to force someone to continue in a business. The agreement should provide for a method by which the dissatisfied participant can dispose of his interest in the enterprise without forcing the other participants to take in a stranger. One method is a right for the enterprise or other participants to buy the interest before it may be offered to outsiders. The provision must cover the method of determining the price and the terms of payment for the dissatisfied owner's interest.

This agreement should also provide for a mandatory buy-out in the event that one of the participants dies, or his disability continues for such a period of time that it is likely that the participant has become permanently disabled. Failure to provide for these contingencies will probably lead to tremendous difficulties for the enterprise. In a partnership, in the absence of an agreement, the death of a participant automatically dissolves the partnership. In a corporation the death of a participant would cause his shares to be transferred either by the terms of a will or, if there is no will, by operation of law to a third party, giving that person a say in the business. Where a participant is permanently disabled, his continued association with the enterprise would more than likely lead to dissatisfaction of the non-disabled participants since they would be carrying his burdens without any additional benefits.

There are a number of methods for valuation of a deceased or disabled participant's interest. Many industries by custom and usage have developed a method of valuation suitable for their industries that may provide guidance to the participants. Also, the provision should not require immediate full payment because of the financial squeeze it would cause on the remaining participants. The parties may desire to fund the repurchase of the deceased or permanently disabled stockholder's interest through the purchase of insurance policies.

CHAPTER 6

MAKING AND KEEPING BUSINESS RECORDS

Making and maintaining business records is both the bane and the backbone of successful businesses. Every enterprise must, of course, keep track of its orders, sales, returns, reports, complaints, and an apparently endless array of other activities and documents. While only about 10% of all records are ever used after storage, complete and accurate records are essential for the effective operation of every business. Your day to day business requirements will largely determine what records you need and must keep, but you should be aware of the following factors concerning records for small businesses generally.

Records for Litigation: In an increasingly litigious society you can count on being in court at some time. You may bring an action to collect money owned you, or someone may sue you claiming your goods or services were in some manner wanting. Depending upon the controversy involved, your case may be won or lost by the completeness and admissibility of your business records.

The length of time you must maintain records varies from state to state. An action must be commenced within a certain time after the underlying activity occurred. This is the so-called "statute of limitations." You must consult your local law to find out the statute of limitations for your state and for the type of activity upon which the lawsuit is based. Florida, for example, allows five years to bring an action based upon a promissory note or written contract, three years if it is an oral contract, but four years if it is a sales contract or an open account. Once an action has been filed these limitations no longer apply. Note, however, that a complaint can be filed and kept without being served for a while, up to three years in California. Records must be kept until the applicable statute of limitations has run, and if suit has been filed, during the pendency of the case.

A regular and established records keeping procedure will assist in having your evidence approved as "business records" - trustworthy writings made "in the regular course of business," at or near the time of the occurrence, for which a custodian of records can attest as to their identity and mode of preparation. You may want to consider formally designating someone to be your "custodian of records" and making sure he or she is familiar with all your record keeping procedures. Otherwise, anyone who is actually knowledgeable and in charge of the records can act as custodian.

Tax Records: Tax returns must be filed at the federal, state, and often county, township, or municipal levels. This requires a lot of mandatory documentation since you must keep records supporting all your positions with respect to taxes, including income, expenses, capital assets, depreciation,

credits, etc. Willful failure to keep required records can result in a $10,000 fine and/or imprisonment. Similarly, when subpoenaed by the I.R.S., these records must be produced for inspection.

Federal tax records must be kept for at least three years, the period in which the I.R.S. can assess additional taxes on federal returns. This period is six years when the taxpayer has not reported an amount equal to or greater than 25% of reported income. There is no period of limitations on fraudulent returns. After assessment, the I.R.S. has six years in which to collect the money, and a taxpayer can request refund of payments within two years after they are made.

State tax records must be kept, depending upon the state, between three and six years for income, two to five years for sales and use tax purposes. In Florida, for example, income tax assessments can be made within three years from the date of filing, sales tax within three years from the due date, and unemployment within five years.

Personnel Records: For each employee you must keep records for social security, unemployment, disability or other state and federal insurance plans such as workers' compensation. In addition, an employer may have to comply with the requirements of O.S.H.A., The Wage-Hour Act, Title VII, and other regulations of more limited application such as the Public Contracts Act. These records must be kept from two to seven years depending on the type of record and applicable law. Pension and profit sharing plans also carry mandatory record keeping and reporting duties.

Protect Your Corporate Veil: If you are conducting business as a corporation your records must reflect that you are treating your business as a corporation and a separate entity. Thus, you should have separate accounts with no commingling of personal and corporate assets, and with business expenses (and no personal expenses) paid for by the corporation. Inability to show the independent vitality of your corporation may result in some unhappy creditor or shareholder "piercing the corporate veil" and holding you personally liable for corporate debts. (See Chapters 10 and 15.)

Form of Record: The originals of many documents such as contracts and signed estimates should be kept, although certain business records can be used in reproduced form. If records prove too voluminous they can be microfilmed, a form acceptable for most state and federal purposes. The I.R.S. has promulgated rules on microfilming specific types of records. The Uniform Preservation of Private Business Records Act, which has been enacted in several states, provides that records may be destroyed after three years unless a longer period is otherwise required by law.

Plan Ahead: Find out beforehand what information will be needed for taxes, sales analysis, contract bidding, commissions, accounting, etc. Whenever possible, combine record keeping procedures for federal and state purposes. Make record keeping a routine and easy part of your office or business procedure. You will probably need accounting assistance from the beginning and should arrange for competent help early on in business operations.

Further Information: There are two publications you should obtain and keep for reference. These contain much useful information and provide specifics for the different states.

1. Your Business Records, A Simplified Guide to What Records You Must Keep and How Long You Must Keep Them, (1977) Prentice-Hall, Publication #727R-9, 24 pages.

2. Recordkeeping Requirements and a List of Tax Publications, (1980) Internal Revenue Service, Publication #552, 4 pages.

CHAPTER 7

KEEPING CORPORATE MINUTES

If you decide to incorporate, you will request an attorney to prepare and file the appropriate papers necessary to create the corporation. The attorney, after doing the work, will provide you with a looseleaf notebook, known as the corporate outfit or kit. Included in it will be the original articles of incorporation, by-laws, the certificate of incorporation signed by a state official, minutes electing the directors and officers of the corporation, and stock certificates with stock ledger indicating who owns the corporate shares. In small business corporations, you and your associates are likely to be the sole shareholders.

After reviewing all the documents with your attorney, the outfit is usually kept in the lawyer's office or given to the client. Unless you expect to refer to the same attorney concerning other business dealings, it would be best to keep these records yourself. Unfortunately, when this happens the records are too often placed on a shelf and left as a memorial of corporate existence, never to be used again.

THE CORPORATE ENTITY

The corporate outfit should continually be updated with records of the significant actions of the corporation. This is because a corporation is technically a separate entity with the directors, you and your business partners, being authorized by state law to manage corporate activities. And regardless of the number of directors or the size of the corporation, directors have certain duties and will perform certain acts - they decide if dividends should be made and to what extent, they may issue more stock, elect officers to run the company and set their salaries. Directors decide whether a lawsuit will be prosecuted or defended in the name of the corporation. They may approve or ratify a settlement in such actions. During the life of a corporation, directors will enter into contracts on the behalf of the corporation, open bank accounts, merge or sell a substantial part of the assets to another company.

All of the above are official acts of the directors for the benefit of the corporation and each should be formally recorded in proper corporate minutes and retained in the corporate outfit. These formalities may seem unnecessary to the small businessperson, but minutes have an important function in any corporation, large or small, and are generally simple to prepare and execute.

THE NECESSITY OF CORPORATE MINUTES

First of all, corporate minutes exist as a standing record of the authority given to and the acts made by the directors and officers. Accurate

minutes avoid future misunderstandings and act as a guide in carrying out the decisions made. In a lawsuit, minutes are generally offered as the best evidence of business transacted, and remember, minutes are often the subject of a subpoena - the failure to provide corporate minutes to substantiate the claim of the corporation could be embarrassing and detrimental to your case. In some cases, the dissent of one director concerning certain actions may even avoid his personal liability.

Quite frequently in business dealings, the other party may require a copy of the minutes giving the corporation or the directors the authority to enter into a transaction. And finally, the recording of accurate minutes may be required by state statute, or the by-laws of the corporation itself.

PREPARING MINUTES

Preparing minutes is generally simple and on most occasions the advice of a lawyer is unnecessary. However, the minutes of certain acts or transactions, especially corporate activities in areas of extensive government regulations, should always be prepared with the advice of counsel. For example, when seeking a particular tax treatment concerning a benefit plan for employees, how the minutes cast the transaction from a tax point of view requires the professional scrutiny of an attorney.

But minutes reflecting the normal functions of the business can be easily prepared. Minutes are taken at the regular annual and monthly meeting of the directors (the number of meetings to be held each year is usually stated in the by-laws), or at any time during the year through a special meeting if all directors are properly notified of the time and place of the meeting.

The following is a sample form of minutes in which the directors, at a special meeting, are performing the relatively routine matter of electing a General Manager for the corporation:

SAMPLE MINUTES

_____ Corporation

SPECIAL MEETING OF THE BOARD OF DIRECTORS

January 15, 1984

A special meeting of the Board of Directors of _____ Corporation was held at the Equity Building at 111 Baker Avenue, Milton, MA, on January 15, 1984, at 10:00 a.m.

The following were present:

(List all present)

Mr. J. P. called the meeting to order and acted as Chairman, Mr. P. R. acted as Secretary and recorded the minutes.

The Chairman announced that a quorum of directors was present and that the meeting, being duly convened, was ready to proceed.

After discussion and upon motion duly made and seconded, it was:

RESOLVED, that Mr. T. J. is appointed General Manager of the Corporation to serve for a period of 2 years to commence on February 1, 1984.

All the directors at the meeting voted in favor of the resolution, except Mr. L. B. who did not vote.

There being no further business, the meeting adjourned at 11:00 a.m.

_____
Chairman

_____
Secretary

The above is a very concise example of the information needed in the minutes: there is a statement of the time and place of the meeting, who attended, who presided and recorded the minutes, if a quorum was present (check the by-laws and state statutes), what business was resolved and how the directors voted. The form can be used as a guide to most business activities and any number of resolved matters can be inserted.

CONCLUSION

Before the minutes are executed by the Chairman and Secretary of the meeting a copy should be distributed to each director to review for accuracy. After this, the minutes should be signed and placed in the corporate outfit as an invaluable permanent record of corporate activities.

CHAPTER 8

MAKING YOUR MARK IN THE TRADE

When one mentions the word "trademark" to most small business operators, the reaction is usually, "Oh no, not me, perhaps when we are bigger." Yet the importance of the trademark to the success of small business operations cannot be too highly stressed. The successful business is one that has built up a reputation with the customer for reliable goods and/or service and has succeeded in being identified with the product. Consumer identification is the key! You must be able to have your company and your product stand out in the customer's mind.

There are so many different types of goods and services being offered by so many different companies that it is often impossible for the consumer to distinguish between companies. This confusion exists equally between the one time purchase and a regular company buyer.

However, in this darkness there is a light. The trademark serves as the company's badge of quality; customers look for it and rely on it when buying new products.

A "trademark" is a word, name, symbol or device, or a combination of them, used by a company to identify its goods to the exclusion of all others. Trademarks include brand names identifying products (BUDWEISER for beer); service marks identifying services (H & R BLOCK for tax preparation service); and collective marks identifying goods, services or members of a collective organization (ELKS for a club).

A company can, over a period of time, build a reputation for its honesty, dependability and quality. That goodwill and standard of quality is symbolized by its trademark. Consumers relying on their past experience with a particular brand name assume that the product they need will be of the same caliber and meet or exceed their expectations.

For example, the trademark ROLLS ROYCE brings instant consumer recognition as a quality car, no matter what year, style or model. The trademark GREEN GIANT reassures the shopper of quality canned vegetables, no matter what type. This is the function of a trademark--to bring an immediate response in the mind of the consumer when he goes forth in the marketplace.

Now you may say that all of this is fine, and you agree trademarks are of value, but how does one proceed to create and protect a trademark.

The creation of a good trademark is a bit more difficult than it may appear. The picking of a good name for a company service or produce can be a simple matter. However, there are many things to consider, given the fact

that the trademark must identify your product alone and not confuse the public.

After you choose a trademark, a professional searching firm is requested to undertake a search to find out if the mark or variation is in use by others for the same or related goods.

Your chosen trademark must not infringe another company's trademark. The legal test of infringement is the likelihood of confusion, mistake or deception of the consumer as to the source of the goods or services.

The mere choosing of a trademark does not give a company rights. A trademark exists only in the actual commercial use of the mark on or in connection with goods or by displaying the mark in the same of services.

A trademark need not be registered to be protected; common law rights protect the first user of a trademark in an area. However, a trademark registered in the U.S. Patent and Trademark Office gives certain rights including, prima facie evidence of ownership, constructive notice nationwide of registrant's claim of ownership of the trademark, Federal Court jurisdiction, different requirements of legal proof, and sometimes treble damages.

The informal symbol "TM" can be used with all trademarks; but only after the trademark's registration in the Patent and Trademark Office can the following notices be used: "Registered U.S. Patent and Trademark Office," "Reg. U.S. Pat. and Tmk. Off." or " R ." The use of these symbols are not mandatory, but serves to put other companies on notice of your rights in the trademark.

Your trademark exists and gives you legal rights indefinitely as long as it is properly used and not abandoned. Once your federal trademark registration is obtained, it must be maintained by the filing of a declaration of current use during the fifth year of registration, and renewed after twenty years.

Ideally, the development and protection of your trademark should be done with your attorney's professional advice. He can help suggest an appropriate trademark, conduct a search for conflicting trademarks, advise as to the mark's legal availability for use, register your trademark and supervise your correct use of the trademark to insure your exclusive right to that trademark and the consumer recognition it brings.

CHAPTER 9

STANDARD CONTRACTUAL TERMS AND CONDITIONS FOR THE SALE OF GOODS

In organizing a business, one of the most tedious but necessary initial responsibilities is creating functional business forms. One of the most important forms in a business which sells goods is the standard terms and conditions of sale which are usually printed on the reverse side of the invoice.

The relationship between a buyer and seller in the business of selling goods is defined in the Uniform Commercial Code which has been adopted with certain variations in every state except Louisiana.

It should be noted that the UCC does not deal with interest charges which is the subject of state, and increasingly federal law. Usually a statement that "interest on past due accounts will be charged at the highest rate allowable by law" will suffice. However, even that approach may not work in certain states which prohibit any interest at all to be charged on certain open accounts for specified time periods. In addition, the discriminatory application of interest rates among customers could be descriminatory pricing under federal and state law in certain instances. At the end of this chapter is a sample form containing the provisions discussed herein. Consult a lawyer before using any provisions supplied herein, they are presented as a guide to alert the businessperson to issues he or she may face in operating a business. Needless to say, depending on the products and services offered, as well as your state, your terms and conditions of sale will vary from those set forth at the end of this chapter. However, certain provisions should be in such contracts in some form or another.

Section 1 of the sample form states that all terms and conditions must be in writing. This provides some protection from salesman's "puffing" about a product or agent's expressions of unauthorized commitments.

Section 2 provides a time limit for the buyer to accept the price quoted.

Section 3 restricts the buyer's cancellation of purchase orders.

Section 4 is probably the most important provision. It is a limited liability clause and is enforceable only if conspicuous. For that reason, the operative language should be highlighted by larger type, underlining and bold-face printing.

Section 5 is self-explanatory and Section 6 protects the seller where the buyer fails to allow shipment as scheduled.

Sections 7 and 8 limit the seller's liability arising from delay in shipping.

Section 9 relieves the seller from insuring goods in transit.

Section 10 is important in that it provides that risk of loss passes to the buyer at seller's place of manufacture (or warehouse).

Section 11 burdens the buyer with making certain claims within a specified time period.

Sections 12 and 13 place the responsibility of certain taxes and fees on the purchaser.

In the event the product is specialized, it may be prudent to use a form of Section 14 which limits the seller's liability with respect to certain patent infringement claims.

Section 15 limits all other warranties and Section 16 provides the governing state law.

Note that a buyer who does not object to terms and conditions within a commercially reasonable time e.g. usually ten business days, may be deemed to accept such terms and conditions.

SAMPLE TERMS AND CONDITIONS OF SALE FORM

1. Any purchase order received by Seller shall be construed as a written acceptance of our offer to sell and shall be filled in accordance with the terms and conditions of sale set forth herein. No other terms and conditions shall apply unless specifically accepted by Seller in writing.

2. All quotations are made for prompt acceptance and any terms quoted therein are subject to change without notice after thirty (30) days from the date thereon unless specifically stated otherwise on the quotation.

3. Purchase orders once placed and accepted can be cancelled only with Seller's written consent and upon terms which will save Seller from loss.

4. All products of Seller's manufacture are guaranteed against defects of material and workmanship for a period of one (1) year from the date shipped when such products are used in the service for which they were manufactured. Seller's liability shall be limited to replacement free of charge of any parts found to be defective in material or workmanship by Seller's inspection, including defects caused by negligence, and shall not include claims for labor costs, expenses of Purchaser resulting from such defects, recovery under general tort law or strict liability or for damages arising from delays, loss of use, or for other direct, indirect, incidental or consequential damages of any kind. THIS WARRANTY IS EXPRESSLY IN LIEU OF ALL OTHER WARRANTIES EXPRESSED OR IMPLIED INCLUDING THE WARRANTY OF MERCHANTABILITY AND FITNESS FOR PARTICULAR USE WHICH EXCEED THE FOREGOING WARRANTY. In the case of products

or parts not wholly of Seller's manufacture, Seller's liability shall be limited to the extent of its recovery from the manufacturer of such products or parts under its liability to Seller.

5. Seller reserves the right to change or modify the design and construction of any of its products, in due course of our manufacturing procedure, without incurring any obligation to furnish or install such changes or modifications on products previously or subsequently sold.

6. Seller reserves the right to invoice and customer agrees to pay for any or all finished material ready for shipment when shipment is held up pursuant to customer's written instructions or for other reasons beyond Seller's control.

7. Promises of delivery are given as accurately as conditions permit and every effort will be made to make deliveries as scheduled. All shipping dates are based on receipt of a firm order with complete information contained therein. Inspection or testing required by Purchaser which affects normal production sequence will be considered as extending the shipping dates accordingly. Seller assumes no liability for damages arising out of failure to deliver material as promised.

8. Seller shall not be liable for failure or delay in delivery due to acts of God, orders bearing priority rating established pursuant to law, differences with workmen, local labor shortages, fire, flood or other casualty, governmental regulations or requirements, shortages or failure of raw materials, supplies, fuel, power or transportation, breakdown of equipment, or any other causes beyond Seller's reasonable control, whether of similar or dissimilar in nature than those enumerated. Seller shall have such additional time within which to perform as may be reasonably necessary under the circumstances and shall have the right to apportion its production among its customers in such a manner as it may consider to be equitable. In no event shall Seller be liable for any consequential damages or claims for labor resulting from failure or delay in delivery.

9. Seller endeavors to pack or prepare all shipments so that they will not break, (rust) or (deteriorate) in transit, but does not guarantee against such damage. No shipments are insured by Seller against damage or loss in transit.

10. Unless otherwise specified in our sales quotation: (a) transportation charges shall be based upon point of manufacture and shall be paid by the Purchaser; (b) customs duties, consular fees, insurance charges and other applicable charges shall be borne by the Purchaser; and (c) responsibility for goods sold shall pass to the Purchaser F.O.B. point of manufacture, unless otherwise specifically accepted by Seller in writing.

11. All claims regarding shortages must be made within thirty (30) days from receipt of shipment and must be accompanied by the packing list(s) covering the shipment.

12. Any tax or other charge imposed by law on the sale of goods or the performance of services shall be paid by the Purchaser, unless the law specifically provides that such payment must be made by Seller.

13. Consular fees for legalizing invoices, stamping bills of lading, or other documents required by the laws of any country or destination, are not included in quotations or selling prices.

14. Seller warrants that the use or sale of material or apparatus sold or rented by it to Purchaser hereunder will not infringe patents of others covering such material or apparatus by itself, and hereby agrees to indemnify Purchaser against judgment for damages for such infringement of any such patent, provided that Purchaser shall, upon receipt of any claim for infringement of any such patent or threat of suit for such infringement or upon the filing of any suit for infringement, whichever comes first, promptly notify Seller, in writing, and afford Seller full opportunity, at its option and its own expense, to answer such claim or threat of suit, assume the control of the defense of such suit, and settle or compromise same in any way Seller sees fit. Other than court-awarded judgments, as aforesaid, Seller shall not be liable for any delays, loss of use or for other direct, indirect, incidental or consequential damages incurred by reason of any such judgment. Seller does not warrant that such material or apparatus (a) will not infringe any such patent when not manufactured by or for Seller, or when specially made, in whole or in part, to the Purchaser's design specification and such infringement arises from the inclusion of such specified design, or (b) if used or sold in combination with other material or apparatus, or if used in the practice of a process, will not, as a result of such combination or use, infringe any patent covering such combination or process, and Seller shall not be liable for, and does not indemnify Purchaser for, damages or losses of any nature whatsoever resulting from actual or alleged patent infringement arising pursuant to (a) or (b) above.

15. All other representations, warranties and conditions, expressed or implied, statutory or otherwise, relating to material or apparatus supplied by Seller or services provided by Seller in connection therewith, are excluded, unless specifically agreed to in writing.

16. This agreement formed hereby and the language herein shall be construed and enforced under the laws as in effect in the State of _____ on the date hereof.

CHAPTER 10

AVOIDING LIABILITY AS AN AGENT IN BUSINESS TRANSACTIONS

Congratulations, Mr. Jones; as President of the newly-formed XYZ Corporation, you have just secured a $100,000 loan for the working capital needed to get your company on the road to success. You chose to incorporate your business principally for the limited personal liability which corporate status provides, a comforting thought as you prepare to sign the note for the bank's loan to the Corporation. Even if business should take a turn for the worse, the company may go under, but your house, car and personal savings would be safe from the bank's collection efforts. Right?

Well, if you signed the note "XYZ Corporation by John Jones, President" and were authorized by the Corporation to do so, you are correct and safe from personal liability. But if you signed "XYZ Corporation, John Jones" or simply "John Jones," even if XYZ Corporation was named above in the note at the borrower, there is real danger that the bank could successfully sue you to collect the loan if the Corporation fails to pay it. And if the bank has assigned the note to a third party, your personal liability is even more certain.

The problem of corporate versus personal liability arises because corporations (or any other business entities, for that matter) can transact business only through officers and employees acting as agents for the corporation. Of course, one corporation may transact business as the agent of another, though in such situations, the agent corporation ultimately must act through some individual officer or employee. Thus, when you or your company act as an agent, representing another party in any business transaction, you must constantly be aware that the manner in which you sign documents and the information or lack of information which you provide the party with whom you are dealing can make you, rather than the principal whom you represent, liable to the third party on the contract you negotiate.

The three cardinal rules for any agent (whether an individual, a corporation or any other entity) to remember when putting any transaction in writing are these:

1. Always name the principal you represent.

2. Always indicate that you are acting in a representative capacity.

3. Always be sure that the other party knows that you are acting as an agent for someone else.

Exactly what is a sufficient indication of agency and the identity of the principal? Obviously, more than one form may suffice, but here are some

examples of methods which are acceptable according to the Official Comments to Section 3-403 of the Uniform Commercial Code, which most states have adopted in the portion of its code of laws which regulates "negotiable instruments" such as notes, checks and other so-called commercial paper. As suggested previously, a signature in the form "XYZ Corporation by John Jones, President" obligates the corporation but not the individual. To carry that example one step further, "ABC Corporation by XYZ Corporation, John Jones, President" would obligate ABC Corporation but not its agent, XYZ Corporation or XYZ Corporation's President, Jones. If the body of a document contains an identification of the principal, such as a note indicating "XYZ Corporation promises to pay . . .," a signature "by John Jones, President" obligates XYZ Corporation, but not Jones.

Assume that any other form of signature as an agent may cause trouble for you. Worst of all is simply signing "John Jones" without indicating either the name of your principal or the fact that you are acting as an agent. In this case, even if you have evidence that the party with whom you dealt knew of your representation of XYZ Corporation, you probably will not be allowed to present it in court and therefore will be personally liable on the instrument you signed. If you sign either "XYZ Corporation, John Jones" (indicating the principal but not your representative capacity) or "John Jones, President" (indicating your representative capacity but not the identity of your princiapl) and have the evidence that the other party did know all the facts, a court may consider your evidence of that. If the other party tells a different story, however, the outcome obviously is uncertain. You may escape personal liability, but you still will have been forced to take the time, trouble and expense of fighting a legal battle when an obviously proper signature probably could have prevented the entire controversy.

Common contractual relationships such as leases and agreements for the purchase or sale of goods or real estate fall outside of the Uniform Commercial Code's regulation of negotiable instruments, but the legal principles involved are substantially the same, with more slight variations from state to state. For example, an individual or small corporation may act as agent for a larger one in purchasing goods or property to avoid drawing attention to the transaction and possibly raising the price for that and future purchases. If the principal should change its mind about the purchase, however, the agent can be left holding the bag and the contract. Unless you are prepared to honor any contract you sign without disclosing the name of your principal or are prepared to accept the consequences for breaching the contract, do not sign it without both indicating the name of your principal and the fact that you are acting as an agent.

An agent who is held personally liable on a contract he was authorized to sign for his principal is entitled to be indemnified for his loss by having the principal reimburse him for the amount he pays. If the principal is bankrupt, however, this right is not much consolation to an agent with a now-empty bank account. Finally, you should remember that the principal-agent relationship is indeed a two-way street and that, even if you sign a contract correctly and your principal is found to be obligated to your customer on it, the principal may be able to sue and recover from <u>you</u> if you exceeded the

authority given you in the transaction and thus caused the principal to suffer a loss.

The discussion above is not a complete summary of the law of agency or negotiable instruments. It is designed to alert a businessperson unexperienced in acting as an agent to the significant legal and financial problems which careless negotiation and signature of documents can cause for him or her. There is no method of transacting any kind of business which can be guaranteed to prevent all legal problems, but some basic attention to elementary principles of the law of agency can do a great deal to eliminate unpleasant surprises.

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CHAPTER 11

THE PROMISSORY NOTE - MORE THAN JUST AN I.O.U.

Our economy is based on credit and no businessperson can avoid coming into contact with that mysterious instrument of debt, the promissory note.

It is mysterious because a note's apparent simplicity is deceiving - years of credit transactions and related disputes have resulted in a refined body of law which dictates the wording of a promissory note.

For example, in order for a promissory note to be negotiable it must include the magic words (or their equivalent): "pay to the order of _____" rather than just "pay to _____." This provision alone will not make the note negotiable - among other requirements the debt evidenced by the note must be payable at an ascertainable time that is not contingent on uncertain events.

At the end of this chapter is a sample promissory note which is presented as a guide in order to demonstrate some of the more important elements in a note.

In order to be enforceable under state law, the note must state the names of the payor and the payee. If a third-party is guaranteeing the note, that fact could be included in the note or in a separate instrument.

The note should be dated and should state the principal amount of the debt. Consideration is a legal term which essentially means the inducement or cause for entering into the note or contract. This inducement should be recited at the beginning of the note.

The interest rate should be set forth, which rate may be set according to a formula, e.g. "2% above the prime rate as determined by XYZ Bank." Before setting a rate which may be too high, check the usury laws of your state.

The sample note is an installment note because the payments are spread out over a period of time. The place and manner of payment should be set forth.

Generally, a note given by a corporation will be subordinate to certain other debt of the corporation such as secured or prior debt. Provisions to this effect may be included in the note.

If the payor has the right to prepay the note, that should be set forth. Conversely, if the payee has the right to convert the note into another debt or equity instrument of the obligor (or payor), appropriate provisions should be included.

The following chapter discusses the granting of a security interest in the payor's property which is done in conjunction with a note or other instrument of debt. If security is given with respect to the debt either pursuant to a mortgage or security agreement, such collateral agreements should be referenced in the note.

Although a note may be negotiable by its terms, in certain cases the transfer of the note may violate certain federal or state securities laws since a note is technically a security. A common provision states that the note will be transferred only in accordance with the securities laws. This provides protection to the payor from participating in the illegal sale of securities in the narrow set of circumstances where the issue arises.

There should be a section in the note defining events of default and the consequences thereof, which could include the acceleration of the note, additional interest charges and the payment of attorney's and collection fees.

In order to expedite enforcement of payment of the note in the event of default, the payor may be asked to waive certain rights otherwise granted to him under state law. These rights include the right of presentment and demand for payment and the right to receive notices of dishonor and protest.

A provision stating the law governing the note should be included. Finally, the maker of the note should sign it.

SAMPLE PROMISSORY NOTE

$80,000.00

February 1, 1984
P. O. Box 821
New York. N.Y. 10022

14% SUBORDINATE INSTALLMENT PROMISSORY NOTE

FOR VALUE RECEIVED, ORANGE CORP. ("ORANGE") acting by and through its President, J. B. Orange, promises to pay to the order of APPLE CORP., the sum of EIGHTY THOUSAND DOLLARS ($80,000.00) in such coin or currency of United States of America as at the time of payment shall be legal tender for the payment of public and private debts with interest from March 1, 1984 until paid at the rate of 14% (percent) per annum.

This note is payable in Three Hundred (300) equal monthly installments of NINE HUNDRED SIXTY THREE AND 00/100 DOLLARS ($963.00), commencing on the first day of April, 1984 and continuing on a like day of each month thereafter until fully paid. Each installment includes accrued interest to date of payment. Interest shall be computed on a 365-day year basis. Payments of interest and principal shall be made at the offices of Apple Corp., or its successor in New York, N. Y. or at such place as the holder hereof shall have designated in writing at least thirty (30) days prior to the date such payment is to be made by Orange.

The failure to pay any installment when due shall cause the entire unpaid balance on this note to become immediately due and payable at the election of the holder hereof. In case this note is placed in the hands of an attorney for collection, Orange promises to pay a reasonable attorney fee in addition to the sum owed on said note including principal and interest.

The maker hereof is hereby granted by the payee the privilege of prepayment of this note, in whole or in part, at any time prior to maturity.

The holder of this note, by acceptance hereof, agrees that this note has been acquired for investment and not with a view to distribution or resale, that this note will not be transferred or disposed of except in accordance with the Securities Act of 1933, as amended, and the Rules and Regulations promulated thereunder by the Securities and Exchange Commission and (relevant state securities laws).

(optional default provision)

The holder of this note may, at his option, declare it immediately due and payable.

(a) If Orange shall make an assignment for the benefit of creditors or shall admit in writing its inability to pay its debts as they become due;

(b) If Orange shall file a voluntary petition in bankruptcy, or shall be adjudicated a bankrupt or insolvent, or shall file any petition or answer seeking any reorganization, arrangement, composition, readjustment, liquidation, dissolution or similar relief under the present or any future federal bankruptcy act or other applicable federal, state or similar statute, law or regulation, or shall seek or consent to or acquiesce in the appointment of any trustee, receiver or liquidator of Orange or all or any substantial part of its properties;

(c) If, within sixty (60) days after the commencement of any proceedings against Orange seeking any reorganization, arrangement, composition, readjustment, liquidation, dissolution or similar relief under the present or any future federal bankruptcy act or other applicable federal, state or similar statute, law or regulation, such proceeding shall not have been dismissed, or if, within sixty (60) days after the appointment, without the consent or acquiescence of Orange, of any trustee, receiver or liquidator of Orange or of all or any substantial part of its properties, such appointment shall not have been vacated.

Upon any distribution of assets, dissolution, winding-up, liquidation or reorganization of Orange, the indebtedness evidenced by this note is, and shall be, subordinated and subject in right of payment to the prior payment in full of the principal of, premium, if any, and interest on, all indebtedness of Orange or guaranties of indebtedness of its subsidiaries as at any time and from time to time shall exist, and any extension, renewal, refunding, or modification in whole or in part thereof shall not affect such subordination.

The holder, by acceptance hereof, agrees to be bound by and takes this note subject to the foregoing subordination.

The maker, endorser and sureties hereof, hereby severally waive protest, demand notice of protest and non-payment in case this note is not paid at maturity.

This note is secured by a (Real Estate Mortgage or Security Agreement dated . . . .).

IN WITNESS WHEREOF, this note is made, and ORANGE CORP. has caused this note to be executed by its President and the corporate seal to be hereunto affixed this 1st day of February, 1984.

ORANGE CORP.

BY_____
President

ATTEST:

_____
Secretary

CHAPTER 12

A CREDITOR'S BEST FRIEND - A SECURED INTEREST IN THE DEBTOR'S PROPERTY

In the last fifteen years one of the most progressive commercial statutes has been implemented with certain variations in every state with the exception of Louisiana. The statute is known as the Uniform Commercial Code and attempts to codify decades of often confusing and conflicting case law involving commercial situations. The UCC recognizes the importance of credit in business and attempts to facilitate the use of credit by establishing procedures relating to the grant of a secured interest in collateral of a debtor in favor of a creditor.

A security interest is nothing more than a lien or mortgage on certain property of the debtor. Unlike many liens, however, a security interest is usually perfected prior to a default. It is done at the onset of the credit transaction in most cases.

A security interest is often granted in conjunction with a promissory note. Sometimes, it is granted when a debtor purchases goods or services and is granted in conjunction with an open account.

The important thing to remember is that a security interest must be in writing and must be perfected either by possession of the collateral and/or recordation of what is known as a UCC Financing Statement ("Form UCC-1"). Where the Form UCC-1 is recorded depends on certain factors - for example, whether the security interest granted is on inventory, goods in process of manufacturing, fungible goods, goods in transport, fixtures, agricultural products, livestock, etc. The better practice is to file both centrally and locally, e.g. with the local county clerk and the Secretary of State. Filing fees are nominal and by filing both with the Secretary of State and on the county level some additional comfort is assured. However, this may not provide complete protection in the event the collateral is moved to another jurisdiction where no filing has been recorded. If the collateral is sold or another security interest granted to a new creditor by the debtor, the original creditor could lose his interest (although the creditor would have a cause of action against the debtor). There is usually a four month grace period where collateral is removed from a state whereby a perfected security interest is still secure, but a new security interest must be filed in the new state. Certain changes in the status of the parties to the transaction or the collateral should be reflected in an amended Financing Statement.

Although the UCC forms are readily available at most stationery stores, it is advisable to consult with an attorney before granting or taking a security interest. Having signed a promissory note, a security agreement is usually executed. The final step is the filing of the Form UCC-1. At the end of this chapter is a sample security agreement. It is presented only as a

guide to alert both sides of a credit transaction involving a security interest as to what obligations and rights each party might have.

The recital should state the amount of debt which the security interest is intended to secure.

Section 1 references the collateral. The collateral must be specifically described and can be described in an attachment to the security agreement. Most states allow the security agreement or description of the collateral therein to be filed with the Form UCC-1.

In Section 2 the debtor makes certain covenants mainly going to the protection of the collateral.

Section 3 defines a default and Section 4 states the steps which the secured party is allowed to take upon such default.

Section 5 allows the secured party to protect the collateral in the event the debtor fails to do so.

Section 6 provides for the details of the sale of the collateral by the secured party in the event of default.

Section 7 expressly provides for the authorization for the secured party to file a Form UCC-1.

The final section states which state law shall govern the agreement.

The agreement should be executed and witnessed.

Upon payment of the debt, the security interest can be released in most states by the filing of Form UCC-3 in the same offices where the original Form UCC-1 was filed.

SAMPLE SECURITY AGREEMENT

AGREEMENT made this ____ day of _____, 1984 between _____ CORP., INC., a _____ corporation (herein called the "Debtor") whose business address is _____ and _____ (the "Secured Party") whose address is _____.

WHEREAS, the Debtor has issued a promissory note in the principal amount of $_____ bearing interest at the rate of ___% per annum payable commencing _____, 1984, in ____ equal monthly installments of $_____ each plus interest which note was issued in connection with the purchase by the Debtor of _____ from the Secured Party; and

WHEREAS, the Debtor and Secured Party have agreed that the outstanding principal obligation under the promissory note shall be secured by a security interest on behalf of the Secured Party in (property) of Debtor having a sound insurable value of at least 150% of such outstanding principal balance,

NOW, THEREFORE, it is agreed that:

1. Debtor hereby grants and conveys to the Secured Party a security interest in, and mortgages to the Secured Party, the (property) more fully described in the schedule hereto ("Schedule A"), which collateral has a sound insurable value of at least 150% of the principal amount of the promissory note.

2. Debtor warrants, covenants and agrees as follows:

(a) To defend title to the collateral against all persons and against all claims and demands whatsoever, which collateral, except for the security interest granted hereby, is lawfully owned by the Debtor and is now free and clear of any and all liens, security interests, claims, charges, encumbrances, taxes and assessments except as may be set forth in the schedule.

(b) On demand of the Secured Party to do the following: furnish further assurance of title, execute any written agreement or do any other acts necessary to effectuate the purposes and provisions of this Agreement, execute any instrument or statement required by law or otherwise in order to perfect, continue or terminate the security interest of the Secured Party in the collateral and pay all costs of filing in connection therewith.

(c) To retain possession of the collateral during existence of this Agreement and not to sell, exchange, assign, loan, lease, mortgage or otherwise dispose of the same without the written consent of the Secured Party.

(d) Not to remove without the written consent of the Secured Party the collateral outside of the (County of _____).

(e) To keep the collateral free and clear of all liens, encumbrances, taxes and assessments.

(f) To pay, when due, all taxes, assessments and license fees relating to the collateral.

(g) To keep the collateral, at Debtor's own cost and expense, in good repair and condition and not to misuse, abuse, waste or allow to deteriorate except for normal wear and tear and to make same available for inspection by the Secured Party at all reasonable times.

(h) To keep the collateral at Debtor's own cost and expense insured to the collateral's sound insurable value, naming the Secured Party as the primary beneficiary of such insurance to the extent of the outstanding indebtedness secured by this Agreement and to furnish certificates of insurance in compliance with this subparagraph.

3. (a) An event of default shall be deemed to have occurred if prior to the time the obligations under the promissory note have been fully satisfied and discharged any one or more of the following shall occur:

(i) If any payment of principal or interest due to be paid under the promissory note is not paid within 30 days following the receipt of notice from the holder of the note of the failure to make such payment;

(ii) If the Debtor shall become insolvent or make an assignment for the benefit of creditors; or

(iii) If bankruptcy, reorganization, arrangement, liquidation or receivership proceedings shall be instituted by or against the Debtor and such proceedings are not dismissed within 30 days after commencement.

(b) Upon the occurrence of any one or more of the events of default, the Secured Party, its successors or assigns may at its option by at least ten days prior written notice or notices declare the entire unpaid principal and all accrued interest under the promissory note of the Debtor to be forthwith due and payable.

4. (a) In the event of the declaration referred to in paragraph 3. (b), the Secured Party shall have all of the rights, remedies and privileges with respect to repossession, retention and sale of the collateral and disposition of the proceeds as are accorded to a Secured Party by the applicable sections of the Uniform Commercial Code of the State of _____ respecting "Default," in effect as of the date of this Security Agreement.

(b) Upon any default, the Secured Party's reasonable attorneys' fees and the legal and other expenses for pursuing, searching for, receiving, taking, keeping, storing, advertising, and selling the collateral shall be chargeable to the Debtor.

(c) The Debtor shall remain liable for any deficiency resulting from a sale of the collateral and shall pay any such deficiency forthwith on demand.

5. If the Debtor shall default in the performance of any of the provisions of this Agreement on the Debtor's part to be performed, Secured Party may perform same for the Debtor's account and any monies expended in so doing shall be chargeable with interest to the Debtor and added to the indebtedness secured hereby.

6. In conjunction with, addition to or substitution for those rights set out under Section 4, Secured Party, at his discretion may:

(a) Enter upon Debtor's premises peaceably by Secured Party's own means or with legal process and take possession of the collateral, or render it unusable, or dispose of the collateral on the Debtor's premises and the Debtor agrees not to resist or interfere.

(b) Require Debtor to assemble the collateral and make it available to the Secured Party at a place to be designated by the Secured Party, reasonably convenient to both parties.

(c) Secured Party will give Debtor reasonable notice pursuant to the provisions of the Uniform Commercial Code of the State of _____ of the time and place of any public sale thereof or of the time after which any private sale or any other intended disposition thereof is to be made. The requirements of reasonable notice will be met if such notice is mailed, postage prepaid, to the address of the Debtor shown above, at least twenty days before the time of sale or disposition.

7. The Secured Party is hereby authorized to file a Uniform Commercial Code Financing Statement.

8. The terms, warranties and agreements herein contained shall bind and inure to the benefit of the respective parties hereto, and their respective legal representatives, successors and assigns.

9. This Agreement shall be construed under the laws of the State of _____.

IN WITNESS WHEREOF, the parties hereto have hereunto set their hands and seals the day and year first above written.

DEBTOR: _____

By: _____

ATTEST: _____

SECURED PARTY: _____

WITNESSED: _____

CHAPTER 13

THE UBIQUITOUS TRUTH-IN-LENDING LAWS

The Truth-in-Lending laws were enacted to foster the informed use of credit through the disclosure of credit terms. Because the act is construed liberally and terms are defined broadly, these laws often extend to seemingly uninvolved transactions. Thus, you should scrutinize every agreement which charges a fee for, or otherwise permits, deferred payments for consumers to determine whether you are required to make the Truth-in-Lending disclosures. In 1980 Congress radically revised and simplified the Truth-in-Lending laws to reduce paperwork and ease creditor compliance.

The basic requirement is that when there is an extension of "consumer credit," the "creditor" must disclose to the debtor certain information, the principal items being any "finance charge" and the interest designated in terms of an A.P.R. - Annual Percentage Rate. "Credit," as used in the Act, refers to simply deferring payment as well as deferring debt for which a charge is imposed. An appropriate transaction will be considered "credit" if it is payable in more than four installments, even though no finance charge or interest is imposed. "Finance charge" is similarly broad and includes all charges imposed directly or indirectly on the debtor for a specific extension of credit, except for credit card membership fees and a bona fide late payment charge or penalty when nonpayment puts the account in default. Where a merchant and a finance company have an intimate and ongoing relationship involving routine assignment of discounted contracts, the discount is a finance charge and must be disclosed by both.

The following checklist will determine whether or not your transaction requires the Truth-in-Lending disclosures:

1. Is credit extended to a natural person (not a business entity) "primarily for personal, family, or household purposes?"

2. Is there a finance charge imposed OR is payment to be made in more than four installments (excluding any down payment) pursuant to a written agreement between the parties? (Installments must be by formal written agreement, not just the debtor unilaterally extending payment and the creditor acquiescing in the terms.)

3. Do you regularly extend or arrange for the extension of consumer credit? ("Regularly" is defined as being involved in more than 25 extensions of credit in the preceding calendar year or current year, whichever is greater, OR 5 extensions if the credit is secured by a dwelling.)

4. If the transaction is not secured by real property, then is the amount financed $25,000 or less?

If you answered "yes" to all four questions, then you probably must disclose clearly and conspicuously, the required information to the person(s) obligated on the transaction prior to the consummation of the contract. Keep in mind that your own situation may fall within one of the many exclusions contained in the law, and you should always consult the Act, regulations, and commentary to make an accurate determination for your specific transaction.

The information required to be disclosed by the law varies according to the type of transaction. The typical credit sale (a "closed end credit" transaction) for example, requires disclosing:

1. The identity of the parties.

2. The amount financed (with an explanation of the term). The amount financed must be itemized only if requested by the consumer, who must be informed of this option and make an initialed request for, or waiver of, the information.

3. If the amount financed is itemized, you must disclose:

   a. the amount of proceeds provided directly to the consumer;

   b. the amount credited to the consumer's account with the creditor;

   c. the amount provided to, and the identity of, third parties;

   d. any prepaid finance charge.

4. The amount of any finance charge (with an explanation of the term).

5. The annual percentage rate or "A.P.R." (with an explanation of the term) unless the finance charge is $7.50 or less.

6. Any circumstances allowing an increase in the A.P.R. of the finance charge, the effects of such an increase, and an example of possible resultant payment terms.

7. The payment schedule for all payments, whether or not subject to disclosure above.

8. The total of all payments (with an explanation of the term).

9. Any provision whereby the obligation can be payable on demand (not including any default as provided for in the underlying contract for sale).

10. Total sales price (with an explanation of the term).

11. Any amounts which may be rebated and/or charged for prepayment

of the obligation.

12. For ongoing transactions, any late payment charges.

13. Any security interest retained as part of the transaction.

14. Any charges for insurance or concerning the security interest.

15. A reference to the underlying contract for sale concerning certain information.

16. For transactions involving a residential mortgage, whether subsequent purchasers can assume the contract on its original terms.

17. Any required deposits, and a statement that the A.P.R. does not include these deposits.

Non-sale credit, loans, credit card, real property, and refinancing transactions all have their own disclosure requirements. The regulations provide examples of acceptable definitions of the terms and instructions as to necessary location of some information and matters of form.

While there are many exceptions to the rule, if you are going to require a security interest in the debtor's principal residence you must also disclose to the debtor and any other resident whose interest is impaired by the security interest, their right to rescind the agreement within three business days following consumation of the agreement, and provide them with the requisite forms. They will retain this right to rescind until the disclosures and form are provided, for up to three years. Should they exercise this right by written notice, you must return all payments and take any steps necessary to expunge the security interest within 20 days, whereupon the debtor must tender the purchased materials or, if appropriate, the value of the materials. You must then take possession within 20 days or the debtor can keep the materials without obligation.

If you do not disclose the information required by the Truth-in-Lending law, you will be open for a lawsuit where there will be a guaranteed minimum recovery for the debtor of $100 plus reasonable attorneys fees for the debtor's lawyer, in addition to any actual damages suffered. The consumer can also assert your failure by way of a set-off or recoupment defense if sued.

Should you discover some mistake you made in good faith, you may escape liability if you notify the consumer within 60 days of your discovery of the error and prior to suit or written notice from the consumer, OR the mistake occurred despite "reasonable procedures meant to avoid the error," OR you were acting in good faith reliance upon a Federal Reserve Board interpretation or the official staff commentary.

Even with the recent simplification, Truth-in-Lending remains a complex area with many special rules for different situations. State laws may also impose additional requirements for consumer credit disclosures and you must proceed carefully. You should use the appropriate forms designed to

facilitate compliance and obtain copies of the Truth-in-Lending law ("Consumer Credit Protection Act"), Regulation Z which governs its implementation, and the Official Staff Commentry. You should also obtain forms used pursuant to Regulation M which covers consumer leasing. These can be obtained from, and your questions answered by, the Board of Governors, Federal Reserve System, Washington, D. C. 20551, attention Division of Consumer & Community Affairs.

CHAPTER 14

EMPLOYEE OR INDEPENDENT CONTRACTOR? - A LOOK AT THE DISTINCTIONS BETWEEN HIRING AND CONTRACTING

When a business becomes large enough to employ several permanent workers, it may suddenly be exposed to significant liabilities and administrative headaches, and a worker's status as either employee or non-employee "independent contractor" has significant consequences for both the worker and the employee. For example, the compensation of an employee is subject to FICA (Social Security) and FUTA (unemployment) taxes, and if the employer fails to withhold such taxes when required to do so, he or she becomes liable for unpaid taxes and penalties. No such withholding is required when payments are made to an independent contractor, who is responsible for paying such taxes directly in the form of self-employment taxes. Unfortunately, every year a number of employers are dismayed to discover that an IRS auditor has reclassified workers assumed to be independent contractors as employees, imposing a substantial and unexpected tax liability on the employer based on the employer's failure to withhold for such workers in previous years.

There are additional consequences: Deductions for contributions to qualified employee benefit plans can disappear for failure to properly classify a worker, because the percentage and nondiscriminatory classification coverage tests which must be met include most employees and exclude non-employee independent contractors. The classification may determine whether payments made by the business to a worker are deductible -- payments to employees are almost always deductible as wages under Sec. 162 of the Internal Revenue Code, while payments to an independent contractor may not be. For example, payments made to an in-house architect who draws construction plans are deductible as wages. If the same work is performed by a non-employee, payments may instead be considered to be a capital expense, not deductible but instead subject to depreciation. An employer must provide detailed reporting information concerning employees and must withhold income taxes from employee's wages. The employer is liable for work-related injuries suffered by employees under workmen's compensation laws, and can be held liable for any harm caused to others by employees while working. Independent contractors, however, are directly responsible for their own tax and reporting obligations, and don't expose their employer to liability for injuries they cause or suffer. Independent contractors are not covered by employee benefit plans, but may set up their own.

Congress has long attempted and consistently failed to enact legislation that would clarify the distinction between employee and independent contractor. Most recently, when the last major tax revision act was passed (the Tax Equity and Fiscal Responsibility Act of 1983, or "TEFRA"), Congress considered and rejected a safe-harbor test for defining independent contractor status that had wide taxpayer support. TEFRA does provide that two classes of

workers (qualified real estate agents and "direct sellers") will be considered to be independent contractors if certain statutory requirements are met. But for all others, the taxpayers, courts, and the IRS will continue to argue over the issue. Because the last word on who is considered to be an employee is usually had by either the Internal Revenue Service or by state and federal courts, the employer must be aware of the factors they consider important.

The "Control Test"

Generally, an employee/employer relationship exists when the person for whom the services are performed has the right to control and direct the individual who performs the services. This control concept relates both to the result to be accomplished and to the details and means by which that result is accomplished. An "employee" is subject to the will and control of the employer, not only as to what is to be done, but also as to how, when, and where it shall be done.

In contrast, an "independent contractor" agrees, usually by contract, to provide a finished product or service and is not subject to control of his physical conduct as he performs the job. For instance, a contractor who agrees to build a home is usually considered to be an independent contractor, even if the homeowner provides specifications, modifies plans, chooses materials and colors, or only allows work to proceed when he is present.

Stockbrokers, physicians, construction contractors, corporate directors and public stenographers are usually independent contractors. Drivers, in-house babysitters, motel managers, corporate officers and managers, teachers, artists, and physicians working as company doctors, are usually employees.

In practice, unfortunately, the distinction between an employee/employer relationship versus an independent contractor relationship is often difficult to define, and workers who seem to do the same work may be classified differently. For example, a restaurant chef is generally regarded as an employee under the "control" test, even though the owner of a fine restaurant will rarely choose or be permitted to exercise much control in the kitchen. A freelance screenplay writer who has the right to work when and where he or she chooses without supervision is probably an independent contractor, but if the writer is not permitted to write for others, or is provided with transportation, a secretary, and reimbursement for expenses, he or she may instead be considered to be an employee for purposes of the Internal Revenue Code and tort liability.

Factors to Consider

In struggling with the definition of an employee, the courts have identified as many as fifty factors that may be helpful in deciding any one case. The Internal Revenue Service provides its agents with a list of twenty such factors for use in their examinations. Some common characteristics from both sources indicate that an employee usually:

(a) Is controlled by the employer concerning the details of the work;

(b) Does not have a distinct occupation or separate business, unlike an independent contractor who often works for several different employers at the same time;

(c) Is directly supervised by the employer on a day-to-day basis;

(d) Possesses a relatively low degree of skill or education;

(e) Has supplies, tools, place of work, and hours to be worked provided and determined by the employer;

(f) Is part of a continuous and regular production shift or cycle;

(g) Is compensated by time or salary, while an independent contractor is usually paid by job, completed project, or commission;

(h) Provides services that are part of the regular business of the employer.

On the other hand, an independent contractor usually:

(a) Has the right to choose assistants or crew without interference from the employer;

(b) Provides tools and equipment, indicating that he is in business for himself and that his own skills will determine whether he realizes a profit or loss;

(c) Negotiates concerning the compensation he or she will receive, which is payable by the job, case, account, or transaction, instead of by the hour, week, or month (although numbers of hours worked may be a factor in computing compensation);

(d) Provides his or her own office space, staff, and equipment;

(e) Carries liability insurance and may be covered by performance or indemnity bonds;

(f) Is not subject to the internal policies of the company, including the making of reports and participation in internal training programs; does not participate in company-provided programs and services, such as payroll, account collection, materials storage, equipment maintenance, pension plans, and other benefit programs;

(g) Is not subject to termination - rather, when an independent contractor fails to complete the job, the employer has a contractual right to enforce their agreement or obtain damages for breach of that agreement.

Structuring the Worker Relationship

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Once the employer has decided what form a working relationship should take, it is important to satisfy as many of these factors as possible. A written contract is advisable, and the contract should define the rights and duties of each party, which should then be adhered to in practice by both parties. Using the desired label (employee, partner, independent contractor, etc.) is insufficient, if the actual relationship differs from the terms of the contract.

A sample independent contractor agreement incorporating provisions which address many of the factors discussed above follows. It is important to remember, however, that the drafting of employment contracts is a complicated and important part of running a successful business, and it is unlikely that any one relationship with an independent contractor or employee will possess all of the characteristics discussed above. Furthermore, there may be other factors that apply to the particular facts of your business relationships, which should also be included in such an agreement.

SAMPLE INDEPENDENT CONTRACTOR AGREEMENT

THIS AGREEMENT is entered into on this _____ day of _____, 19___, by and between _____, an independent data processing consultant ("Consultant") and THE COMPANY ("Company").

WHEREAS, the Company is engaged in the business of providing technical assistance, management consulting, and related data processing services; and

WHEREAS, Consultant is a qualified data processing consultant engaged in the business of providing expertise in such areas;

NOW, THEREFORE, it is mutually agreed as follows:

1. Project. The Company has entered into an agreement with _____ _____ (hereinafter referred to as "Customer") to complete a project for Customer by providing such technical assistance and related data processing services as are described on Exhibit A hereto. Exhibit A may be amended from time to time as Customer may so designate to the Company, and the Company shall immediately advise Consultant of any such modification.

2. Duties, Responsibilities, and Requirements of Consultant.

2.1 Qualifications and Services. Consultant warrants that Consultant has the expertise, qualifications, and capability to perform and complete the project set forth on Exhibit A, and will use his best efforts in completing the project on a timely basis, and devote as much time as is necessary to complete it in a satisfactory and timely manner.

2.2 Location. Consultant's services will be performed at Customer's or Consultant's premises. Unless otherwise agreed in writing, the Company will not provide facilities or premises for Consultant's use.

2.3 Supplies and Equipment. Consultant will provide his own supplies, tools, and equipment necessary to complete the project. Consultant warrants that he maintains an independent business and has the resources to satisfactorily complete the project.

2.4 Expenses. Consultant shall be responsible for and pay all fees and expenses of his business. In the event the Company elects or is required to advance sums to pay expenses for Consultant's account, Consultant agrees to reimburse the Company on demand.

2.5 Insurance. Consultant shall maintain adequate insurance for his business, and will provide proof of such insurance to the Company upon request, including employer's liability insurance or worker's compensation, comprehensive automobile liability, and comprehensive general liability and property damage insurance.

2.6 Bond. Consultant agrees to obtain a bond in favor of the Company and Customer in an amount equal to $_____, and to furnish proof of said bond to the Company.

3. Status of Parties.

3.1 Independent Contractor. It is understood and agreed that Consultant is an independent contractor and is not an employee, partner, or joint venturer of the Company. To the extent permitted by law, Consultant shall have the sole and absolute discretion in judgment in the manner and means of carrying out his business activities. Consultant shall provide proof to the Company if requested that he has obtained all necessary licenses, paid all necessary fees, filed all necessary tax returns, paid all income, self employment, FICA, FUTA, and excise taxes or other taxes necessary, filed all state industrial insurance and unemployment compensation forms and paid all premiums necessary and consistent with his status as an independent contractor.

3.2 Authority of Consultant to Obligate the Company. The Company shall not be liable for any obligtions incurred by Consultant, nor shall Consultant have the authority to bind the Company in any manner with respect to a particular transaction without the Company's specific authorization.

4. Fees. Consultant shall receive fees based upon actual hours expended on the project. The Company agrees to compensate Consultant for said hours expended at the rate of $_____ per hour. Consultant shall submit invoices to the Company every two weeks, accompanied by Consultant's time reports. If the Company does not agree with the amount of the invoice or the number of hours which Consultant's time reports indicate Consultant spent on the project, the Company shall so advise Consultant within five (5) days.

5. Term of Agreement and Termination.

5.1 Term. The term of this agreement shall commence on the date first above written and shall continue in full force and effect until completion of the project.

5.2 Termination. This agreement shall be terminated earlier if Customer, for any reason, notifies the Company and/or Consultant that: (i) Customer is abandoning the project prior to completion and that further services will not be required; or (ii) Consultant's services are not satisfactory. The Company may terminate this agreement at any time for cause upon written notice to Consultant. Cause for termination shall include but not be limited to failure by Consultant to provide quality services to Customer or failure by Consultant to devote a satisfactory amount of time to the project.

5.3 Right to Income Upon Termination. In the event of termination for any reason whatsoever, Consultant shall be entitled to timely payment of all fees due under this agreement so long as said fees were earned prior to termiantion.

6. Non-Exclusive. Consultant's obligation under this agreement is to satisfactorily complete the project and meet all deadlines set forth in

Exhibit A. Consultant has no obligatin to work any particular hours or days, or any particular number of hours or days. Consultant retains the right to contract for similar services with other businesses.

7. Confidential Information. Consultant agrees not to utilize or disclose any confidential information obtained from Customer or the Company. Confidential information includes, without limitation, information which relates to the past, present, or future business activities, clients, pricing, methods, financial data, research, and client or product development.

8. Indemnity. Consultant agrees to indemnify and hold the Company harmless from all claims, demands, and liabilities, including costs and attorneys' fees, to which the Company is subjected by reason of any breach by Consultant of the terms of this Agreement or by any action taken or not taken by Consultant, unless such action or inaction was at the specific request of the Comapny. The Company agrees to indemnify and hold Consultant harmless from all claims, demands, and liabilities, including costs and attorneys' fees, to which Consultant is subjected by reason of the Company's breach of the terms of this agreement or by its negligent act or inaction.

9. Miscellaneous. This Agreement is not assignable. Except as to Exhibit A, amendments to this Agreement shall be in writing and be signed by each of the parties. This Agreement shall be governed by the laws of the State of _____.

THE COMPANY

By_____

CONSULTANT

By_____

CHAPTER 15

STRUCTURING AN EMPLOYMENT AGREEMENT WITH A CLOSE CORPORATION

Elsewhere in this Guide, we have seen the advantages of operating a business through a corporate entity. The limited personal liability of controlling persons as well as the tax benefits usually outweigh the expense and trouble of maintaining the corporate existence. However, there is much more to maintaining the corporation than the annual state report and franchise taxes. The case books are thick with unfortunate instances where the "corporate veil" was pierced for the benefit of a creditor or claimant to the detriment of a shareholder or employee of the ill-fated corporation. This piercing, in most cases, occurs because the facts support the argument that the corporation was not treated or used as a separate entity distinct from the shareholders. One important way to insure the corporate structure is maintained is to hold regular board of directors and shareholders meetings and document such meetings with minutes. As awkward as it sounds, even where there is only a sole shareholder or director, a meeting can usually be held in the form of a unanimous written consent in order to approve corporate action. Chapter 7 explains the importance and mechanics of keeping minutes.

Another important technique for maintaining the corporate structure is documenting all transactions between the corporation and persons who might be held liable for corporate debts in the event the corporate veil is pierced. For example, loans by officers to corporations should be documented by minutes of the board of directors or shareholders approving the loan and a promissory note which includes terms of repayment. The risk of not doing this is that a creditor of the corporation could claim that the "loan" to the corporation was in fact a contribution to capital. The relevance of this argument is that a lender has certain strong rights, say for example, if the corporation should enter bankruptcy, while a shareholder (one who contributes capital) is the last to be paid in a bankruptcy liquidation and in some states has additional liabilities as well, such as the obligation to pay certain employee wages.

If the controlling shareholder simply uses the corporation as his own personal bills-paying conduit, this is evidence of ignoring the corporate entity and limited liability could be lost. Even if the corporate veil is not pierced, other shareholders could claim that they are being damaged through the diversion of funds which was not authorized by the board of directors as evidenced by an employment or consulting agreement.

An employment agreement also puts the IRS at ease. The IRS often claims that what a shareholder claims as wages are actually dividends. Dividends are not deductible by the corporation while wages are.

At the end of this chapter is a form of employment agreement. It has been designed for a close corporation. Of course, an employment agreement may

also be used to define the relationship between the corporation and its otherwise unaffiliated employees. The emphasis on such agreements would be on covenants not to compete provisions and protection of corporate secrets (see Chapter 16).

As is true with all forms included in this Guide, the employment agreement is presented for discussion purposes only in order to highlight relevant issues and should only be used under the supervision of an attorney. With that in mind, let's examine the provisions of a sample employment agreement.

The recitals or preface should contain the date of the agreement and the names and addresses of the employer and employee.

Section 1 establishes the term of employment and a general description of duties. By keeping the employment term to one or less year, the corporation's balance sheet does not have to book the aggregate liabilities to the employee as long-term debt.

Section 2 should state the annual salary. This should be reasonable in light of geographical and similar business practices.

Section 3 should include other benefits. A bonus provision is optional but could be used to justify payments above the base salary. A provision should also be included allowing reimbursement for expenses. In this section, an automobile for business purposes could also be granted to the employee.

Section 4 obligates the employee not to disclose corporate secrets or to compete with the corporation. These restrictive competition covenants are often vulnerable to attack as being an unreasonable restraint on an employee's right to earn a living. The narrower the restriction in terms of time, geography, and work limitations, the more likely the restriction will be upheld in litigation.

Section 5 should state the amount of working time the employee will contribute to the business. This provision could note that the employee is involved in other activities and will devote less than all his working time to the corporation.

Sections 6 and 7 state the circumstances by which the employment relationship can be terminated due to non-performance or breach by either party.

Section 8 establishes ownership of trade secrets and inventions in favor of the corporation. If the employee has claims to certain inventions or trade secrets which are desired by the corporation, a separate licensing agreement should be used.

The remainder of the agreement is self-explanatory. The agreement should, of course, be executed. Although a person signing on his own behalf as employee, can also legally sign on behalf of, and bind, the employer, it is preferable to have another agent of the corporation bind the employer.

SAMPLE EMPLOYMENT AGREEMENT

AGREEMENT, dated this ____ day of _____, between _____ ("EMPLOYER"), a _____ corporation with offices at _____ and _____ ("EMPLOYEE"), residing at _____.

W I T N E S S E T H

In consideration of the mutual covenants herein contained:

1. Employment. Subject to the terms and conditions of this Agreement, Employer agrees to employ Employee for a period of _____ months commencing with the date hereof to serve as the _____ of Employer with responsibility for operations and overall profitability and in such other executive position with Employer, or its subsidiaries, as may be designated by the Chief Executive Officer or Board of Directors of Employer. Employee's employment shall be extended annually thereafter pursuant to the terms of this Agreement unless modified or terminated in accordance with the terms of this Agreement.

2. Compensation. For services rendered to Employer and its affiliates during the term of this Agreement, in whatever capacity rendered, Employer shall compensate Employee with a salary at the rate of _____ dollars per annum. The salary shall be payable in accordance with Employer's normal payroll practices.

3. Benefits; Bonus; Expenses.

3.1 Employee shall be entitled to participate in such pension, group health, accident or life insurance plans, group medical and hospitalization plans, and other similar benefits, as may hereafter be available to the employees of Employer. It is understood that, except as set forth herein, Employer does not by reason of this Agreement obligate itself to make such benefits available to its employees.

3.2 Employer hereby agrees to pay Employee at the end of each year during the Employee's term of employment hereunder a bonus to be determined by the Employer in its sole and absolute discretion, which bonus shall be based upon Employee's performance.

3.3 Employer shall pay or reimburse Employee for all expenses normally reimbursed by Employer and reasonably incurred by him in furtherance of his duties hereunder and authorized by Employer, including expenses for entertainment, traveling, meals, hotel accommodations and the like upon submission by him of vouchers or an itemized list thereof prepared in compliance with such rules relating thereto as the Employer may from time to time adopt and as may be required in order to permit such payments as proper deductions to Employer under the Internal Code of 1954, as amended, and the rules and regulations adopted pursuant thereto now or hereafter in effect.

3.4 After each twelve (12) months of the term of this Agreement, Employee shall be entitled to a fully paid three (3) week vacation.

4. Noncompetition; Nondisclosure.

4.1 During the period of his employment, Employee shall not engage directly or indirectly, either as substantial stockholder (which means owning, along with relatives who reside in his home, corporation, partnerships or businesses under his control at least 5% of the outstanding capital stock), partner, officer, director, employee, consultant, agent or otherwise in any business which competes with any business of Employer or its subsidiaries. The foregoing covenant of the Employee will also apply to the period ending twelve (12) months from the date this Agreement is terminated in the event this Agreement is terminated as a result of the default by Employee hereunder, provided, however, that in the event of such termination of this Agreement, the area in which Employee shall be prevented from competing with Employer shall be limited to (list geographical area).

4.2 Employee shall not, at any time during or following expiration or termination of his employment (regardless of the manner, reason, time or cause thereof), directly or indirectly, use for his own benefit or disclose or furnish to any person not entitled to receive the same for the immediate benefit of Employer or its subsidiaries any trade secrets or confidential information including, without limitation, information as to the business methods, customers, suppliers, operations and affairs of Employer or its subsidiaries.

5. Covenants. Employee will (a) faithfully and diligently do and perform the acts and duties required in connection with his employment hereunder; and (b) devote his full time during normal working hours and engage exclusively in the business of Employer and its subsidiaries as now or hereafter conducted.

6. Incapacity. In the event that Employee shall become incapacitated through accident or sickness and thereby be prevented from performing his duties hereunder temporarily or permanently, the Employee shall nevertheless be entitled to the compensation and other payments provided for hereunder for a period of two (2) months from the inception of such incapacity except that if such incapacity is a result of an injury incurred in the performance of his duties under this Agreement, Employee shall be entitled to the foregoing for a period of three (3) months from the inception of such incapacity. Thereafter, Employer may, if it so elects, declare Employee's employment terminated by reason of the continuance of such incapacity beyond such two (2) month period or three (3) month period, as the case may be. In the event that Employee is incapacitated for a continuous period extending beyond two (2) months or three (3) months, as the case may be, and Employer does not elect to declare Employee's employment terminated, Employee shall not be entitled to receive the compensation and other payments provided for hereunder for any time after the end of such two (2) month period or three (3) month period, as the case may be, until he commences working again for Employer.

7. Termination. This Agreement shall be terminated upon the happening of any of the following events:

(a) Whenever the Employer and the Employee shall mutually agree in writing to terminate this Agreement.

(b) Upon the death of the Employee.

(c) At the Employer's option, if the Employee shall:

(i) be in breach of or default under any provision of this Agreement; or

(ii) be convicted by a court of law having jursidiction of the Employee of fraud, misappropriation, embezzlement or any crime constituting a felony; or

(iii) become incapacitated as referred to in Section 6.

(d) At the Employee's option, if the Employer shall:

(i) be in breach of or default under any provision of this Agreement; or

(ii) become insolvent or bankrupt or file a voluntary petition in bankruptcy or make an assignment for the benefit of creditors or consent to the appointment of a trustee or receiver; or

(iii) a trustee or receiver is appointed for Employer's properties and appointment is not dismissed or stayed within ten (10) days thereafter; or

(iv) bankruptcy, reorganization or liquidation proceedings are instituted against Employer or are consented to by it, and such proceedings are not dismissed within ten (10) days.

8. Inventions. Employee agrees that all invoices, copyrightable material, secret processes, formulae, trademarks, trade secrets and the like, discovered or developed by him while in the employ of Employer or its subsidiaries, whether in the course of his employment, on time or property of Employer or its subsidiaries, or otherwise, shall be the exclusive property of Employer and Employee agrees to execute such instruments of transfer, assignment, conveyance or confirmation and such other documents as may be requested by Employer to transfer, confirm and perfect in Employer all legally protectable rights in any such inventions, copyrightable materials, secret processes, formulae, trademarks, trade secrets and the like.

9. Notices. Any notice required or permitted to be given under this Agreement shall be sufficient if in writing and if sent by registered mail to his residence in the case of the Employee, or to its principal office in the case of the Employer.

10. Entire Agreement; Waiver. This Agreement contains the entire understanding of the parties and may not be changed orally but only by an agreement in writing, signed by the party against whom enforcement of any waiver, change, modification or discharge is sought. Waiver of or failure to exercise any rights provided by this Agreement in any respect shall not be deemed a waiver of any further or future rights.

11. Assignment. The rights and obligations of the Employer under this Agreement shall inure to the benefit of and shall be binding upon the successors and assigns of the Employer. The rights and obligations of Employee under this agreement are personal and may not be assigned.

12. Survival; Remedies.

12.1 The provisions of Section 4 shall survive termination of this Agreement and be deemed to be independent convenants, except that the provisions of Section 4.1 shall not survive termination effected pursuant to the provisions of Section 7(d).

12.2 The parties agree that money damages at law would be an inadequate remedy with respect to any breach by Employee of the covenants contained in Section 4 and it is hereby stipulated that Employer shall be entitled in respect to any such breach, in addition to any other remedies which it may have, to apply to any court of competent jurisdiction to enjoin any violation of Section 4 of this Agreement.

IN WITNESS WHEREOF, (EMPLOYER) has caused this instrument to be signed by a duly authorized officer and Employee has hereto set his hand the day and year first above written.

(EMPLOYER)

By_____

ATTEST:

_____

EMPLOYEE:

_____

WITNESS:

_____

Chapter 16

Do You Want to Know a Secret? - Utilizing A Confidental Disclosure Agreement

All businesses possess certain information which is valuable and should be kept confidential. However, inevitably situations will arise where such information will have to be disclosed to third parties, especially where the business is a new one. For example, potential investors, employees, consultants, suppliers, maintenance persons, licensees, franchisees, customers or potential purchasers of the business or a division all may come into contact with confidential information.

There is an evolving body of law dealing with how to keep trade secrets "secret." There are differing views on what steps a business must take in order to evidence the intent to keep information secret - a key element in upholding the proprietary nature of the information. One court held that allowing high school students on a guided tour access to a manufacturing plant voided the rights of the business to win a lawsuit based on theft of secret information relating to a manufacturing process. The court found that the company, by allowing the public to see the process, did not "intend" to keep the process secret.

The point is that the act of treating information as secret is necessary in order to prevail in an action against an infringer of such secrecy. One method, when used in conjunction with other secrecy-consistent procedures, to protect the confidentiality of proprietary data is the use of confidential disclosure agreements. This offers the added legal protection of being able to sue an infringer for breaching a contractual obligation as well as for a tort (which means "civil wrong").

At the end of this chapter is a basic type of confidential disclosure agreement which, in consultation with an attorney, could be modified to fit the secrecy needs of many types of businesses.

The agreement may be in letter form and should refer to the circumstances or proposed transaction giving rise to the need for confidentiality.

The phrase, "confidential information" should be as broad as possible in order to provide additional protection. However, in order to prevent the definition from being too broad, and perhaps meaningless, the agreement should carve out from the definition of confidential information certain material, e.g. material already in the public domain (such as patents) or information already possessed by the disclosee.

The disclosee should agree not to disclose the confidential information except under very limited, specified instances and only after efforts have been taken to prevent unauthorized persons from obtaining the information.

The agreement should also obligate the disclosee to mark the tangible forms of the information with secrecy legends.

Finally, once the disclosee has used the information as contemplated, all such information and copies should be returned to the discloser.

SAMPLE CONFIDENTIAL DISCLOSURE AGREEMENT

Discreet Corporation
222 Second Avenue
New York, New York 10027

February , 1984

Snoopy Corporation
456 Garst Mill Road
Roanoke, Virginia 24859

Re: Confidential Disclosure Agreement

Gentlemen:

In connection with the proposed asset purchase agreement (the "Proposed Transaction") between Discreet Corporation (hereinafter referred to as "Discloser"), and Snoopy Corporation ("Disclosee"), Discloser has furnished, and will be furnishing, to Disclosee certain Confidential Information pertaining to Discloser. This Confidential Information includes all unpublished information, whether technical, business or otherwise. Such information, which may be patentable or unpatentable, relates, without limitation, to Discloser's inventions, materials, tooling, machinery, equipment, designs, processes, formulae, costs, business or marketing plans, research or development efforts or plans, customers and price lists. Certain of this Confidential Information has been, and will be, disclosed in writing and other information has been, and will be, furnished through oral communications.

Discloser agrees to disclose and/or to grant access to such Confidential Information to Disclosee upon the following terms and conditions:

1. Disclosee agrees that it shall:

   (a) hold in confidence and not disclose or make available to any third party any such Confidential Information, unless so authorized in writing by an officer or authorized employee of Discloser;

   (b) exercise all reasonable efforts to prevent third parties from gaining access to such Confidential Information;

   (c) not use, directly or indirectly, any such Confidential Information, except to evaluate and determine its interest in the terms of the Proposed Transaction, unless so authorized or requested in writing by Discloser;

(d) restrict the disclosure or availability of such Confidential Information to those of Disclosee's employees who have a need to know; and insure that its employees who shall have access to Confidential Information are informed of the terms and conditions of this Agreement and will take such steps as are necessary to insure that each such employee agrees to be bound by them;

(e) promptly mark any such Confidential Information which may be reduced to documentary or other tangible form with the legend "SECRET MATERIAL;" take such other protective measures as may be or become reasonably necessary to preserve the confidentiality of such Confidential Information;

(f) in the event that for any reason the Proposed Transaction is not consummated, Disclosee agrees to return all Confidential Information furnished it and any copies thereof which it has made; and

(g) in no event shall Disclosee use such Confidential Information to the detriment of Discloser.

2. In the event that for any reason the Proposed Transaction is not consummated, the aforesaid requirements of confidentiality and restriction on use of Confidential Information shall continue indefinitely; provided, however, that the following information shall not be considered Confidential Information:

(a) Information which, at the time of disclosure hereunder to Disclosee, is in the public domain as evidenced by written publication;

(b) Information which, after disclosure hereunder to Disclosee, enters the public domain by way of written publication through no fault of Disclosee;

(c) Information which Disclosee can show by written document was in its possession at the time of disclosure to it hereunder and which was not acquired directly or indirectly from Discloser;

(d) Information which Disclosee can show by written document was acquired, after disclosure to it hereunder, from a third party who did not receive it directly or indirectly from Discloser under an obligation of confidentiality and who did not require Disclosee to hold such information in confidence;

(e) Information which is published in United States Letters Patent.

3. This Agreement, its validity, construction and performance shall be governed by the laws of the State of _____.

4. This Agreement embodies all of the understandings concerning the subject matter hereof and merges all prior discussions and writings between Discloser and Disclosee as to confidentiality of information and may not be modified except by an instrument in writing signed by both of us.

Kindly confirm that the foregoing represents our agreement with you in respect of this matter by signing below where indicated.

Very truly yours,

Discreet Corporation

By_____

Confirmed and Agreed to:

Snoopy Corporation

By_____

CHAPTER 17

PREPARING FOR A PUBLIC OFFERING OF SECURITIES

The Federal Securities Act of 1933 regulates the offering of securities to the public by a person or business. Pursuant to the Securities Act, Congress delegated to the Securities and Exchange Commission broad powers to promulgate rules and regulations in this area. The S.E.C. is generally considered one of the best and most efficient Federal rulemaking agencies.

Recently, the S.E.C. has taken steps to ease the regulatory burdens on small and mid-size businesses. A recent law, the Regulatory Flexibility Act, requires the S.E.C. to consider the impact of its regulations on small entities prior to the adoption of such regulations.

Under the Securities Act, the S.E.C. is authorized to exempt certain offerings of securities from the registration process because of the small amount of money involved (up to $5,000,000). The most important exemption is Regulation A which exempts a public offering of securities from the registration process if the total amount offered is for less than $1,500,000. However, even under Regulation A certain documents must be filed and reviewed by the S.E.C. regional office in the area the issuer proposes to do business.

The Securities Act was also recently amended to allow an exemption from the registration process for offerings of securities by an issuer solely to one or more accredited investors (a defined term which includes institutional investors and other financially sophisticated investors) if the aggregate offering price is less than $5,000,000 and there is no public solicitation. This amendment as well as others favorable to small businesses resulted from the enactment of the Small Business Investment Incentive Act of 1980.

The well-known private placement rule - Rule 146 - has been replaced by Regulation D which sets forth the conditions for when an issuer will not be deemed to be making a public offering (and thus be exempt from the registration process) regardless of the aggregate offering price of the securities. The two basic requirements are that there must be less than 35 purchasers (excluding those high net-worth persons designated as accredited investors) who are "sophisticated" (fully understand the risks) and no publicity is allowed in promoting the sales. Chapter 18 discusses raising capital through private placements.

If the securities are offered solely intrastate, e.g. to persons residing within the same state, an exemption from the registration process is available under Rule 147. This is a difficult exemption to use since even one inadvertent out-of-state resident who purchases a security could void the entire exemption.

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In addition to the Federal securities regulatory scheme, most states regulate the offering and sale of securities through "Blue Sky" statutes. These state regulations must be complied with in addition to the Federal statutes. However, usually the state statutes mesh nicely with the Federal registration process and often registration by coordination is allowed. This entails supplying essentially the same information to the state as was provided to the S.E.C.

Regardless of whether the Federal or state registration process applies to a particular securities offering, one important point should be remembered. Under Section 10b of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder by the S.E.C., it is illegal to make any untrue statement of a material fact (or omit to state a material fact) in connection with the purchase or sale of any security. "Security" is a broadly defined term and has been the subject of much litigation--even a simple promissory note could be a security.

Once the issuer decides to make a public offering, a lawyer should be consulted to determine the correct form to file with the S.E.C. Even if an exemption from registration is available, in most cases filings with the S.E.C. are still required. The general form is Form S-1. Recently, the S.E.C. promulgated Form S-18, which is a simplified registration and reporting form for first-time issuers. In 1982 the S.E.C. adopted the Integrated Disclosure System in order to coordinate various private placement exemptions and to coordinate and streamline the S.E.C. registration and disclosure requirements.

In deciding whether to undertake a public offering of securities, the following disadvantages should be considered:

1. The issuer will generally be required to comply with the continuing reporting and disclosure requirements of the Securities Exchange Act. This is expensive and time consuming.

2. The issuer loses flexibility and must obey certain fiduciary duties and other regulations imposed on controlling stockholders and "insiders" by the Securities Exchange Act. Corporate procedures such as regular meetings, notices, and elections must be followed. Conflicts of interest must be avoided.

3. The entire registration process is expensive.

4. Often the management of a public company becomes more concerned with the short-term market price of the stock to the detriment of long-range corporate planning.

5. There is dilution of control by the previous owners of the issuer.

The above disadvantages must be balanced against the following advantages:

1. Large amounts of capital may be raised to expand the business or decrease existing debt.

2. Liquidity of the investors' capital in the business results from the market and trading with respect to the stock.

3. A public company is usually more prestigious. This added prestige may aid in attracting employees and increasing customer and supplier confidence.

4. The issuer's balance sheet will be strengthened and this will facilitate additional financing.

5. The issuer is in a better position to diversify through acquisitions by using its own stock as a substitute for cash.

It should be noted that an issuer can do a public offering by issuing securities other than common or preferred stock. For example, notes or debentures could be offered. Moreover, a package of stock and warrants or options to buy more stock could be floated. Nor does the issuer in a public offering have to be a corporation. For example, a technique gaining popularity in the last decade is the public limited partnership vehicle which issues units of interests in the partnership. This structure allows tax advantages to be passed through to the limited partner and is the common structure for businesses which raise money by offering tax shelter benefits to investors.

Regardless of which form is used in going public, certain information must be supplied to the S.E.C. or the public (sometimes the S.E.C. requests confidential information "supplementally" which means, upon request by the issuer, such information will not be disclosed to the public). From the issuer's perspective it is sometimes difficult to understand the purpose behind the Federal securities laws, which is ostensibly to protect the investor. However, for the most part, the S.E.C. rules comport with good business sense and are no more than what a business should be complying with in order to protect profits.

A business or promoter cannot start too early in getting advice from an accountant and lawyer. Although the requirements for audited financial statements vary depending on the type of issuer, the better shape the issuer's financial records are, the easier the registration process will be.

One of the initial steps is the selection of an underwriter. It is possible to successfully complete an offering without an underwriter, but unless one has knowledge of the marketing of securities, it is ill-advised not to have an underwriter.

The marketing of securities in a public offering may only be done through the use of a prospectus. No additional sales material can be used unless accompanied or preceded by a prospectus. Because of the very strict antifraud sections of the Federal securities laws (including Section 10b), no sales literature should be used unless carefully reviewed by a lawyer.

The information in the prospectus (or offering circular, if not a public offering) should include the following basic information:

1. The purpose of the offering and how the proceeds will be used.

2. How the securities will be marketed.

3. Extensive information regarding the issuer such as:

   a. the capital structure of the issuer, and

   b. when and where organized or incorporated.

4. A description of the business of the issuer including properties owned, competition, government regulations affecting the business and products or services sold.

5. Whether there is any litigation pending or threatened against the issuer.

6. Extensive information about the securities being issued, such as voting, dividend, preemptive, conversion and other rights (preemptive rights give a shareholder the right to maintain his proportionate interest in the business by having the right to purchase securities in future offerings).

7. Information regarding officers and directors, such as business background and remuneration from the issuer.

8. Whether there are outstanding options or warrants with respect to the issuer's stock.

9. Financial statements.

10. The amount of dilution of the public investors' holdings as a result of securities previously issued at a price lower than the public offering price.

In addition, certain information must be included in the registration statement which does not appear in the prospectus such as the filing of certain exhibits including material contracts, purchase orders, and organizational documents such as certificate of incorporation and by-laws.

After filing the registration statement, the staff of the S.E.C. will review it and usually respond with a "letter of comment" which suggests revisions, additions, or deletions.

A public offering of an issuer's securities is only one of many capital raising devices utilized by U.S. businesses. As a result of changes in the law, many small businesses have recently found it to be the method of choice.

CHAPTER 18

RAISING CAPITAL THROUGH PRIVATE PLACEMENTS

The advantages and disadvantages of a public offering of securities were discussed in Chapter 17. A business may avoid the rigorous registration requirements of Section 5 of the Securities Act by issuing securities in a private placement. The Securities and Exchange Commission ("S.E.C."), in an effort to aid small businesses raise capital, promulgated a series of six rules (Rules 501-506) known as Regulation D which took effect on April 15, 1982. Regulation D is an effort to coordinate the various limited offering exemptions and to streamline the requirements for private offers and sales of securities under the Securities Act. Rules 501-503 set forth the general requirements for a Regulation D private placement. This chapter will analyze Rule 506 which is the vehicle most widely used for private placements.

A few caveats are in order. Compliance with Regulation D is only an administrative safe harbor and individuals may challenge the "private" status of the offering as not meeting the requirements for a private offering under Section 4(2) of the Securities Act. The burden of proving an exemption from the Securities Act always lies with the issuer. Compliance with Regulation D exempts the issuer from only the registration requirements of Section 5 of the Securities Act, but not from the antifraud or civil liability provisions of the federal securities laws. The issuer is still obligated to comply with applicable state securities laws which are far from uniform. Clearly, an attorney well-versed in securities laws should be consulted prior to undertaking a private placement.

I. Exemption for Limited Offers and Sales Without Regard to Dollar Amount of Offering

Rule 506 exempts offers and sales to no more than 35 purchasers, excluding accredited investors (discussed below in Section III). Rule 506 requires that the issuer reasonably believe that each non-accredited purchaser, either alone or with his purchaser representative, is sufficiently sophisticated, i.e. has such knowledge and experience in financial and business matters that he is capable of evaluating the merits and risks of the prospective intestment.

II. Calculation of Number of Purchasers

The number of purchasers in a Rule 506 offering is limited to 35 purchasers plus an unlimited number of accredited investers. Integration of similar offerings by the same issuer is significant in the calculation of the number of purchasers. For example, securities sold in a private offering to 20 purchasers in June might be integrated with securities sold in a private offering to 25 purchasers in August. Integration of these offerings would

invalidate the private status of both offerings because the total number of purchasers would have exceeded 35. Offerings that are made at six month intervals will meet the integration safe harbor discussed in Section IV.

Accredited investors and any relative, spouse or relative of the spouse of a purchaser who has the same principal residence as the purchaser are the most notable exclusions from the calculation of the number of purchasers under Regulation D.

III. Accredited Investors

There are 8 categories of accredited investors under Regulation D. They include:

(1) Institutional investors such as banks, registered investment companies, small business investment companies, insurance companies, and certain employee benefit plans.

(2) Private business development companies which provide significant managerial assistance to the issuer of securities which they acquire.

(3) Tax exempt organizations described in Internal Revenue Code Section 501(c)(3) with total assets exceeding $55 million.

(4) Insiders such as directors, executive officers, or general partners of the issuer of the securities being offered or sold, or any director, executive officer, or general partner of a general partner of that issuer.

(5) Purchasers of at least $150,000 of securities provided the total purchase price does not exceed 20% of the investor's net worth (or the joint net worth of an investor and his spouse) at the time of the sale. The purchase may be made by one or a combination of four specified methods: cash; securities for which market quotations are generally available (marketable securities); an unconditional obligation to pay cash or marketable securities within five years of sale; or a cancellation of indebtedness.

(6) Any person whose net worth of all assets at the time of the purchase is $1 million.

(7) A natural person who has an income in excess of $200,000 in each of the last 2 years and who reasonably expects an income in excess of $200,000 in the current year is an accredited investor.

(8) Entities in which all the equity owners are accredited investors.

IV. Integration

Regulation D provides that all sales that are part of the same Regulation D offering must be integrated. The rule provides a safe harbor for

all sales that take place at least six months prior to the commencement of or six months after the termination of the Regulation D offering, so long as there are no offers and sales, excluding those to employee benefit plans, of the "same or similar" securities within either of these six-month periods. Integration under the Securities Act is a complex concept and it is advised that counsel be consulted to evaluate the risk that an offering might be integrated with another offer or whether it meets tne safe harbor test.

V. Informational Requirements

Regulation D does not mandate any specific disclosure for a Rule 506 placement if an issuer sells only to accredited investors. When information must be furnished, the level of disclosure is based on the size of the offering and the nature of the issuer. The information need only be furnished to purchasers. Access alone to that information will not meet the Regulation D informational requirement. It should be noted that the Securities Act mandates disclosure of all material facts regardless of any specific informational requirement or lack thereof.

(a) Non-reporting companies

In offerings up to $5,000,000 an issuer must provide the same kind of information required in Part I of Form S-18, or, for an issuer that is not qualified to use Form S-18, the same kind of information as required in Part I of a registration form available to that issuer. The issuer, under all disclosure requirements, must provide certain financial statements. Counsel should be consulted to determine the type of financial statements needed to meet these requirements.

It should be noted that there are significantly different requirements for those companies subject to the reporting requirements of the Exchange Act.

(b) Other informational requirements

Regulation D also concerns itself with the treatment of exhibits, the right of non-accredited purchasers to receive the same information furnished to accredited investors, the right of all purchasers to ask questions of the issuer concerning the offering, and a specific obligation by the issuer to disclose all material differences in terms or arrangements as between security holders in a business combination or exchange offer.

VI. Limitation on Manner of Offering

Regulation D prohibits the use of general solicitation or advertising in connection with private offerings. This prohibition includes, but is not limited to, the following:

1. Any advertisment, article, notice or other communication published in any newspaper, magazine, or similar media or broadcast over television or radio; and

2. Any seminar or meeting whose attendees have been invited by any general solicitation or advertising.

VII. Filings of Notice of Sale

There is a uniform notice of sales form for use in offerings made pursuant to Regulation D. The notice must be filed with the S.E.C. no later than 15 days after the first sale and 30 days after the last sale. A notice should be filed every six months if the offering period has not terminated. If the offering is completed within the first 15 day period, then only one notice need be filed after completion of the offering to comply with the first sale and last sale notice requirements. One copy of the notice must be manually signed by a person duly authorized by the issuer.

VIII. Limitations on Resale

Securities acquired in a Regulation D offering have the status of restricted securities acquired in a transaction under Section 4(2) of the Securities Act. The restrictions on resale of a security issue in a Rule 506 offering are complex and are set forth in Rule 144 promulgated by the S.E.C.

Regulation D also provides that the issuer exercise reasonable care to assure that purchasers of securities are not deemed to be "underwriters." Such reasonable care includes inquiry as to the investment intent of the purchaser, disclosure of resale limitations, and placement of a legend disclosing such restrictions on the certificate evidencing ownership.

CHAPTER 19

THE INSTALLMENT SALES REVISION ACT OF 1980--AN OVERVIEW

For the taxpayer who receives a small down payment when selling property with the balance due to be paid out over a period of years, the installment method of reporting gain has been a valuable tool. By satisfying certain criteria contained in Section 453 of the Internal Revenue Code, the individual selling a business, or for that matter, property in general, does not have to report all the gain realized from such a sale in the year that the property is actually sold, but rather can report the gain ratably over the period during which payments are actually received. The benefit of utilizing this method is immediately obvious: One who sells property at a profit does not have to pay all the tax due on the profit in the year of sale but rather pays a percentage of the total tax due in each of the years he receives payment.

Previously, the rules pertaining to installment sales were contained in Section 453 of the Internal Revenue Code, however, in 1980 Congress passed the Installment Sale Revision Act of 1980 which created two additional segments augmenting Section 453, these new Sections being labeled Section 453A and Section 453B. Although Section 453 continues to set forth the rules governing sales of real property and casual sales* of personal property, new Section 453A contains the rules covering dealer transactions and personal property whereas Section 453B contains the rules covering dispositions of installment obligations.

The general effect of the new revisions is to ease many of the qualification requirements of old Section 453. Prior to October 20, 1980, the effective date of the new Installment Sales Revision Act, the individual wishing to utilize the installment method of reporting gain had to meet the following criteria:

(a) No more than thirty percent of the selling price of the item could be received in the year of the sale;

(b) The selling price had to be payable in two or more installments spread out over two or more tax years ("Two-payment Rule");

(c) The sales price of the item sold had to exceed $1,000;

(d) The sales price could not be subject to a contingency (i.e., the occurrence of some event); and

*A "casual" sale means that the property is not sold in the ordinary course of business or from inventory.

(e) The seller was required to make a positive election if he wanted to use the installment method.

For sales taking effect after October 20, 1980, the following major changes were made:

(a) The thirty percent rule was eliminated so that under the new Act a sale of real property or a casual sale of personal property qualified for installment reporting so long as the seller received at least one payment after the close of the tax year in which the sale occurred;

(b) The Two-payment Rule was eliminated which in effect made installment reporting available to taxpayers who received lump sum payments in a taxable year subsequent to the year of sale;

(c) The minimum sale restriction requiring the sale to be in excess of $1,000 was eliminated;

(d) The contingency sale requirement was eliminated so that now sales that have a contingent selling price do qualify for treatment as installment sales;

(e) The requirement that a positive election had to be made by a seller was also eliminated so that now a qualified sale will automatically be reported as an installment sale unless the seller elects not to use it (note, however, that once an election has been made not to use the installment sale, this election cannot be revoked without consent of the IRS).

In general then, the Installment Sales Revision Act of 1980 has now made the installment method of reporting gain more accessible to anyone selling property for a profit. Since the effect of utilizing this method is to reduce somewhat the tax consequences of a disposition of property, the new Act should prove to be of benefit to all who can qualify to utilize its provisions.

CHAPTER 20

THE INVESTMENT TAX CREDIT

In 1962, Congress first enacted the Investment Tax Credit ("ITC") to provide business with an incentive to expand operations and upgrade facilities. When the ITC is taken by a taxpayer, it operates as though the Treasury Department shared in the cost of new (and to a lesser extent, used) equipment. The principle characteristics of the ITC are:

1. The credit is generally 10% of the cost of tangible, depreciable property (except land and improvements) purchased or constructed during the year. The allowed credit in any year, however, is subject to a number of limitations.

2. Credits in addition to the investment credit may be available for:

   (a) Corporations that have qualifying employee stock ownership plans;

   (b) Costs incurred in rehabilitating or modernizing existing structures;

   (c) Investments in some types of energy-related properties, even if they also qualify for the 10% ITC.

3. The tax credit amount is a direct dollar for dollar offset to the taxpayer's liability in one year. Thus, a taxpayer who purchases a $10,000 machine reduces his tax liability by $1,000 in that year. If a taxpayer's ITC is greater than his tax liability, the excess credit can be applied against his prior years' income tax liabilities resulting in a refund, or it may be carried forward to be used against future income taxes payable.

4. If a taxpayer sells, abandons, or begins personal use of the ITC property before the date allowed by the IRS, he must repay a portion of the ITC taken.

WHO IS ENTITLED TO CREDIT

Any taxpayer, whether a corporation, partnership, or an individual, who constructs or purchases qualifying property may generally claim the investment credit. Leases often raise a question as to who receives the benefit of the ITC. Generally, a lessee of new investment credit property is only entitled to take the ITC if the lessor elects to pass it on to the lessee. The election is made by the lessor who must file an election statement with the lessee and with the IRS accompanying his return. If an election is not made, the lessee gets no ITC even though the lessee possesses the property for most of its useful life, and, even though the lessee exercises an option to purchase the property under the agreement. Therefore, new businesses who must

lease their property and equipment because of insufficient capital to purchase them outright should be aware that the allocation of the ITC amount (which is either passed through in its entirety or not at all) is a significant item to be negotiated under the lease.

A noncorporate lessor, including a Subchapter S corporation, is entitled to the ITC for property he leases to others in only two instances:

1. Where he manufactured or produced the leased property in the ordinary course of his business. This generally means that the property must be regularly constructed or reconstructed as part of the taxpayer's business;

2. Where the noncorporate lessor does not qualify under #1 above, and the lease agreement conforms to the following two requirements:

   (a) The term of the lease is less than half of the useful life of the leased property; and

   (b) For the first twelve months after the property is transferred to the lessee, the allowable business expnese deductions related to the leased property exceed 15% of the rental income the property produces.

If the noncorporate lessor is denied the ITC, however, he still may elect to pass it through to the lessee.

INVESTMENT CREDIT PROPERTY

Generally, all depreciable, tangible, personal property (other than buildings and their structural components), with a depreciable life of at least three years qualifies for the credit. Three general rules should be kept in mind in determining whether or not the property qualifies for the ITC:

1. The property should be used in the business of the taxpayer. Personal use of the asset will disqualify its eligibility for the ITC.

2. The property should be of a movable nature, that is, it should not be "inherently permanent" or so physically attached to a permanent structure such as a building that its removal would damage the structure. Production equipment fastened to a building floor still qualifies since it does not become as permanent as the structure itself.

3. The property must be used in manufacturing, production, or in the furnishing of transportation or communication in a trade or business.

Some examples of qualifying property are: advertising displays and equipment, carpeting (even though attached to a floor by tacking), computer hardware, fruit orchards, cargo containers, gas pumps and storage tanks, research facilities, automobiles, office equipment (such as typewriters, calculators, and telephone systems), trucks, cranes, movers, and vending machines.

Buildings and their structural components are ineligible for the ITC. This includes air conditioning, heating, and humidifying equipment that are of a central nature, as well as insulation, wiring, and the structure itself. However, movable and removable partitions, lighting fixtures, and drapes may be eligible for the ITC if they otherwise qualify. Research facilities and bulk storage structures that are used in connection with manufacturing or production also qualify under certain circumstances. Structures specifically designed and created for equipment that will likely be replaced with the equipment and that have no other economic use will also qualify for the ITC.

The purchase of used equipment also qualifies for the ITC with three limitations:

1. The property must be purchased. No ITC will be available if acquired by tax-free exchange, inheritance or devise, from a controlled group, or purchased from a person who would not recognize a loss if it had been sold to the taxpayer (for example, by a son to a father).

2. No credit is allowed for used property if, after its purchase, it is used by a person who had used the property before the purchase. This limitation therefore bars any ITC for used property in purchase and leaseback arrangements or when property is purchased by the lessee under a purchase option or by separate agreement.

3. No more than $125,000 of used property may qualify for the ITC. There is no carryover or carryback if the $125,000 ceiling results in unused ITC for any one year.

Special rules and an increased investment tax credit is available for expenditures in the rehabilitation or reconstruction of a building. A more detailed discussion is beyond the scope of this chapter.

WHEN CREDIT IS ALLOWED

The ITC is generally allowed for the taxable year in which the taxpayer places qualifying property in service. This means that the taxpayer is entitled to the entire ITC even though the asset is not placed in service until December 31 of his taxable year. "Placed in service" generally means that the asset is in a state of readiness for its special function. In a situation where the ITC is passed to a lessee, the lessee is deemed to have placed the leased property in service in the taxable year in which the lessor transfers possession of the property to the lessee.

Property qualifies for a partial credit if it is used, in the first year it is placed in service, partly for qualifying (business) purposes and partly for other purposes. Property does not qualify for the ITC, however, if the taxpayer uses it entirely for personal or some other disqualifying purpose during the first year the taxpayer places the property in service. For example, if a taxpayer places property in service in 1983 and uses the property entirely for personal purposes in that year, but in 1984 begins using the property in a trade or business, no credit is allowable in either year or thereafter.

COMPUTING THE CREDIT

The maximum amount of investment credit is generally 10% of the cost of ITC property placed in service during the year. Whether a property qualifies for the maximum ITC depends upon the property's useful life. "Useful life" is the period over which the asset contributes to the production of income, which also corresponds to the same life used for depreciation under ADR, the Accelerated Cost Recovery System (ACRS), or other depreciation method. The credit is calculated by multiplying 10% times a percentage of the basis of ITC property. Generally, the larger the life, the larger is the credit.

Virtually all "ITC type" property is "recovery" property and can be depreciated under the advantageous ACR System. All of the recovery property's basis is eligible for ITC treatment providing its useful life is in the five, seven, ten, or fifteen year categories. For recovery property in the three year recovery period, the 10% investment credit rate is applied against 60% of basis (yielding a 6% overall credit).

For non-ACRS property, the percentage of qualifying property is a function of the useful life, and is determined according to the following schedule.

Useful Life Bracket	Percentage of Basis of Qualified Property
7 years or more	100%
5 to less than 7 years	66-2/3%
3 to less than 5 years	33-1/3%

(NOTE: Whether property is ACRS or non-ACRS is a decision left to the taxpayer that should be made in consultation with your tax advisor. Generally, ACRS treatment of assets provides for shorter depreciable lives, larger depreciation deductions, and greater investment tax credits.)

The following example demonstrates the calculation for ACRS and Non-ACRS property:

Investment Credit Property	Useful Life Bracket	Life Bracket Percentage	Cost	Basis of Credit
ACRS: Telephone Equipment	5	100%	$20,000	$20,000
ACRS: Automobile	3	60%	8,000	4,800
Non-ACRS: Office Equipment	3	33-1/3%	8,000	2,667
Non-ACRS: Injection Mold Machine	10	100%	20,000	20,000
				$47,467
		Credit Percentage		X 10%
		ITC Amount		$ 4,747

For both new and used property acquired in any year, the maximum credit is the sum of the credit for property placed in service during the year, plus any unused credits carried forward or back from other years. The amount of the maximum credit to be taken for any year, however, is limited to the sum of:

1. The lesser of the tax liability for the taxable year or $25,000; and

2. Eighty-five percent (90% for taxable years ending before 1983) of the tax liability in excess of $25,000 for the taxable year. As an illustration, suppose T's maximum investment tax credit and T's tax liability for 1982 and 1983 are each $30,000. The amount of the maximum $30,000 credit allowed is $29,500 for 1982, and $29,250 for 1983:

   1982 = $25,000 (the lesser of $25,000 and $30,000) plus $4,500 (90% of the $5,000 of tax liability in excess of $25,000);

   1983 = $25,000 plus $4,250 (85% of the $5,000 tax liability in excess of $25,000).

(NOTE: After 1982, the basis of ITC property must be reduced by either 50% or 100% of the ITC taken for purposes of determining loss or gain at sale, and for calculating yearly depreciation. This rule is consistent with the underlying theory that part of the cost of ITC property is "paid for" by the Treasury Department.)

CARRYOVERS AND CARRYBACKS

If the available ITC for property placed in service in any year exceeds the maximum credit as calculated above, the excess unused ITC can be carried to preceding and subsequent taxable years. Unused credit carried from a prior year to the current taxable year is treated as part of the total allowable credit for the current year, subject to Treasury Regulations §1.46-2(h). The unused credit can be carried to any of the three prior taxable years which will result in a refund, or the unused amount can be carried over 15 years to offset future tax liabilities.

BUSINESS ENERGY CREDITS

Business taxpayers can qualify for an additional 10% to 15% credit for investing in nine categories of energy property and placing them in service before 1986. If the energy property is also tangible, personal property that qualifies for the regular investment tax credit, both the business energy investment credit and the regular investment credit can be recognized. Solar, wind, and geothermal property are examples of energy property which may qualify for additional investment credits.

SPECIAL TAXPAYERS

Husband and Wife

If a husband and wife file separate terms, the maximum credit is $12,500 of tax liability per return, plus 85% (90% for tax years ending before 1983) of the excess over that amount unless one of them has no qualifying investment (or unused credit). Where one spouse has no ITC investment and has no unused credit to carry over, the other spouse having qualified ITC investments may use the entire $25,000 limitation, plus 85% (90%) of his tax liability in excess of $25,000.

Partnerships and Partners

Each member of a partnership is a separate taxpayer and each partner's share of partnership ITC is determined according to the partnership's agreement to share profits, unless provided otherwise.

The used property ceiling applies both to the partnership and to each partner. Each partner must take into account his portion of the partnership's used property purchases as well as his own independent purchases of used ITC property to determine whether he has exceeded his individual used-property ceiling amount for the year.

RECAPTURE

All or part of the ITC allowed to a taxpayer must be recaptured and repaid as additional tax if the taxpayer prematurely disposes of the ITC property or employs it in a disqualifying use. Recapture will occur if the actual period the taxpayer uses the property in his business is shorter than the life bracket used by the taxpayer in claiming the credit originally. If the property is disposed of (by sale or abandonment, etc.) before the end of its life bracket, part or all of the ITC previously taken will generally have to be added to the tax for the year in which the property is disposed.

The recapture provisions are designed to place the taxpayer in the same position in a year of disposal as he would have been had he correctly claimed the actual life of the property in the year of original acquisition. The taxpayer should determine anew each year whether or not ITC property placed in service in prior years has ceased to qualify.

RECOMMENDATIONS FOR THE NEW BUSINESS

1. The ITC is not restricted to heavy equipment, trucks, or other pure "manufacturing" assets. Virtually every business purchases assets that qualify for the ITC. It is difficult to imagine today's business being run without office equipment and furniture, calculators, typewriters, filing cabinets, desks, telephones, and automobiles. You should first determine whether or not there will be sufficient income to use the ITC. If not, you may decide to lease your ITC property and to negotiate a reduction in the rental fee by allowing the lessor to retain the tax credit.

2. Be careful in converting ITC property from personal to business use. Also beware of purchasing or transferring ITC property from related parties to the business.

3. Consult a tax attorney or CPA when making major purchases. His or her advice might be "buy it no later than Tuesday," apparently nonsense. But the difference between buying a $10,000 asset December 31 instead of January 1 is the difference between paying $9,000 for the asset today, or paying $10,000 and waiting for a $1,000 tax rebate a year hence. At a fifteen percent rate of interest it would cost you $150 to borrow $1,000 for a year. Considering the high cost and difficulty of obtaining credit, having to wait that extra year for a $1,000 or larger tax break might be one year too long.

   Advice on how to structure purchases can be valuable. For example, a taxpayer may plan to purchase a new computer and move his business to accommodate it. If he constructs a new building in which the air conditioning will serve to cool the new computer as well as his employees, he will be able to take ITC only on the cost of the new computer. However, if a separate cooling system is installed apart from the central cooling system he will get the ITC on both the computer and its conditioner, even if the computer cooling system cools other areas of the office. Moreover, if software costs are combined with the total computer hardware cost the taxpayer can take the ITC on the entire transaction. But software that is purchased separately or developed in-house will not qualify.

These are just a few examples of the value of good tax advice, your professional can provide many more.

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CHAPTER 21

THE IMPACT OF ELECTING SUBCHAPTER S STATUS ON START-UP CORPORATIONS

As discussed briefly in Chapter 1, owners of small businesses who choose to operate in corporate form but who wish to avoid the double taxation suffered by regular corporations usually can achieve both goals by electing to have their corporation taxed under Subchapter S of the Internal Revenue Code (hereinafter the "IRC").[1] Although Subchapter S status has been available to corporations for approximately 25 years, the Subchapter S Revision Act of 1982 (the "Act") substantially revised the law in this area, simplified the rules relating to eligibility and eliminated many of the technical provisions that had proved to be traps for the unwary. The goal of this chapter is to summarize the principal provisions applying to "S corporations,"[2] particularly those relating to eligibility for and termination of that status, and the tax treatment of S corporations and their shareholders. Any corporation that is not an S corporation will be referred to herein as a "C corporation." This chapter also seeks to highlight the distinctions between partnership and Subchapter S, since entrepreneurs may now find S corporations to be an appropriate alternative in situations where previously only partnerships were suitable.

PART I: QUALIFICATION FOR SUBCHAPTER S STATUS

There are two requirements imposed on a corporation seeking to elect Subchapter S status -- that it come within the Act's definition of a "small business corporation" and that it make a timely election to be taxed under Subchapter S of the IRC.

Definition of "Small Business Corporation"

A "small business corporation" is any corporation incorporated in the United States that has no more than 35 shareholders, all of which are individuals, estates, or certain qualifying trusts, and which has only one class of stock.[3] Automatically excluded from the definition of "small business corporation" is any corporation owning 80% or more of the stock of any other corporation, certain financial institutions and tax advantaged corporations, "domestic international sales corporations" ("DISC's") or former DISC's.

With respect to the 35 shareholder limitation, it is required that no shareholder, whether it be an individual, estate or trust, can be a nonresident alien. It is noteworthy, as well, that the numerical limitation was set to correspond to the maximum number of unaccredited shareholders permitted under Rules 505 and 506 of Regulation D, which are private placement

exemptions from the registration requirements of the Securities Act of 1933 (see Chapter 18).

The single class of stock restriction obviously precludes the corporation from issuing preferred stock, bonds or any other noncommon stock security. The corporation, however, will not be treated as having more than one class of stock solely because of differences in voting rights, so long as the right to share in the profits and assets of the corporation are otherwise identical among the shareholders.[4] Thus, the founders of a business seeking additional capital could issue nonvoting common stock to outside investors, and still retain the corporation's Subchapter S status.

A persistent problem with respect to the one class of stock requirement, however, relates to the characterization of debt instruments as equity securities. Under traditional tax law principles certain purported debt instruments may be reclassified by the IRS as stock because of their convertibility, subordination, proportionate ownership, and other factors.[5] While the effect of such a reclassification on C corporations is merely to transform deductible interest payments into non-deductible dividends, such a reclassification would destroy an S corporation's Subchapter S eligibility if the reclassified debt were regarded as a second class of stock.

To resolve some of that uncertainty the Act provided that certain "straight debt" will not be treated as a second class of stock. Straight debt is defined as any written unconditional promise to pay a specified sum in money on demand or on a specified date, provided that the interest rate and the time for interest payments are not contingent on profits, the borrower's discretion, or similar factors, that the debt is not convertible, directly or indirectly, into stock, and that the creditor is an entity that would be eligible to be a shareholder of an S corporation.[6] Any instrument that is not straight debt as so defined may be subject to reclassification in accordance with the rules used by the IRS.

Making the Election

An election by a corporation to be taxed under Subchapter S is made by filing a Form 2553 with the IRS. All shareholders in the corporation on the day on which the election is made must consent to, and sign, the election form. If made on or before the fifteenth day of the third month of the corporation's taxable year, the election is effective for the entire taxable year, provided that the corporation would have qualified as a "small business corporation" for the portion of the year before the election was made and that all persons who held stock in the corporation during the portion of the year prior to the election consent to the election. Newly formed corporations will be treated as S corporations from the date of their incorporation if they elect on or before the 74th day following their incorporation. If an election is made after the "grace period" if the corporation was not a small business corporation for the portion of the year prior to election, or if one or more persons who were shareholders for the portion of the year prior to the election do not consent to the election, then the election is treated as being effective for the following taxable year.[7]

Revocation of Election

As a result of changes made by the Act, a Subchapter S election may be revoked only if shareholders holding more than one-half of the shares of stock in the corporation on the day on which the revocation is made have consented to the revocation.[8] A revocation made on or before the fifteenth day of the third month of the corporation's taxable year will be effective as of the first day of that year and any revocation made after that date will be effective on the first day of the following year.[9] A revocation may specify a prospective date.[10]

Termination of Election by Disqualification as a Small Business Corporation

A corporation's Subchapter S status will be terminated if the corporation ceases to be a small business corporation -- i.e., if it acquires more than 35 shareholders, if it acquires an ineligible shareholder, or if it issues more than one class of stock.[11] Any termination of a corporation's Subchapter S status by virtue of its ceasing to be a small business corporation is effective on the date of cessation, rather than retroactive to the beginning of the year.[12] It should be noted that the Act gives the IRS the authority to waive the effect of any inadvertent terminating event if the corporation takes timely steps to correct the situation resulting in termination. Of course, the corporation and each shareholder will be required to agree to make whatever adjustments to their respective incomes as may be consistent with treatment of the corporation as an S corporation for the period of the inadvertent termination.[13]

The revocation or termination of an S corporation's election results in the division of its normal taxable year into two short taxable years, an "S short year" and a "C short year."[14] The Act sets forth a formula for allocating the corporation's income, deductions, and the like between the S short year and the C short year for purposes of determining the income of the corporation subject to corporate tax and the income of the corporation which passes through to the shareholders without corporate taxation.

Termination Due to Excess Passive Investment Income

A Subchapter S election will also be terminated if the corporation has "Subchapter C earnings and profits" at the close of each of three consecutive taxable years beginning after December 31, 1981 and more than 25 percent of its gross receipts for each of those three taxable years consists of "passive investment income." The termination is effective as of the first day of the first taxable year beginning after the close of the three-year period in which the corporation had accumulated such earnings and profits and excess passive investment income.[15] During the three-year period, however, the corporation will have been subject to the tax on its "excess net passive income" described below.

For purposes of this passive income disqualification rule, as well as the tax on excess net passive income discussed below, "Subchapter C earnings and profits" are defined as earnings and profits accumulated in any year, including years prior to 1983, in which no Subchpater S election was in

effect. "Passive investment income," on the other hand, is defined to include gross receipts derived from royalties, rents, dividends, interest, annuities, and the net gains from sales or exchanges of stocks or securities. Interest on installment obligations arising from the sale of inventory, gross receipts directly derived from the conduct of a lending or finance business, and certain distributions from the liquidation of a more than 50 percent owned subsidiary are not treated as passive invest income."[16]

Reelection After Revocation or Termination

Once an S corporation's election terminates, the corporation or any successor corporation is prohibited from reelecting Subchapter S status until the fifth year following the year the termination is effective, unless the IRS consents to an earlier reelection.[17]

PART II: SELECTION OF TAXABLE YEAR

The Act prohibits an S corporation from adopting or changing to any fiscal year other than the calendar year unless the corporation satisfies the IRS that some business purpose justifies another accounting period.[18] Since individuals typically adopt a calendar year for tax reporting purposes, and since each shareholder includes in his or her gross income a portion of the corporation's income for the corporation's fiscal year that ends with or within the shareholder's fiscal year, this rule is intended to eliminate the deferral potentially available by staggering the taxable years of the corporation and its shareholders.

S corporations in existence on December 31, 1982 will be permitted to retain a taxable year other than a calendar year. However, if in any year more than 50 percent of the corporation's stock becomes "newly owned," then the corporation will lose its Subchapter S status unless, for the following year, it switches either to the calendar year or to a year approved by the IRS. Stock will be "newly owned" to the extent that any shareholder's percentage ownership on any particular day exceeds such person's percentage ownership on December 31, 1982. The Act creates an exception to the rules regarding newly owned stock in the case of certain transfers of stock at death or by gift among family members or pursuant to a buy-sell agreement in existence on September 28, 1982.[19]

PART III: TAX TREATMENT OF THE CORPORATION

Reporting at the Corporate Level

Although an S corporation ordinarily incurs no tax liability, it is necessary to compute its taxable income at the corporate level, for purposes of both filing a return (an "information return") with the IRS and determining the constituent elements of the corporation's taxable income of which pro rata shares will be reported by the shareholders. The corporation's taxable income is calculated in the same manner as that of an individual, except that all items of income (including tax-exempt income), loss, deduction, and credit

must be stated separately, to the extent that separate treatment of those items might affect a shareholder's individual tax liability.[20]

Certain deductions, specifically those denied to a partnership under § 703(a) (2), are not allowed in computing corporate taxable income.[21] Because the corporation's taxable income is determined in the same manner as an individual's, the provisions of the Code that afford special treatment to corporations will not apply, such as the § 243 "dividends received" deduction or the provisions of Subchapter C regarding distributions by regular corporations of which the Subchapter S corporation is a shareholder. However, amortized corporate organizational expenses under § 248 are allowed as a deduction.[22]

As is the case with partnerships, the character of any item entering into the computation of the S corporation's taxable income and passed through to a shareholder's return is to be "determined as if such item were realized directly from the source from which realized by the corporation, or incurred in the same manner as incurred by the corporation."[23] Despite the fact that the quoted language might seem to suggest that an item is to be characterized as if realized by a shareholder directly, the courts and the IRS have generally interpreted virtually identical language in the partnership area as requiring characterization at the entity level. Thus, for example, a determination whether real estate is a capital asset or whether it should be denied capital asset treatment as "property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business" probably should be made with reference to the activities of the corporation rather than its shareholders.

Most elections that affect the computation of items flowing through to the shareholders are made at the corporate level.[24] However, certain specific elections that affect shareholder tax liability are required to be made individually by each shareholder. These elections relate to determining the effect of income from the discharge of indebtedness, aggregating certain net lease properties for purposes of the investment interest limitation, deduction and recapture of certain mining exploration expenditures, and the claiming of foreign tax credit.[25]

It should be noted, as well, that subject to certain exceptions, the income of an S corporation will be taxed separately if its net capital gain exceeds both $25,000 and 50 percent of the corporation's taxable operating income in that year, and if the corporation's taxable income for that year is greater than $25,000.

Tax on Excess Passive Investment Income

If an S corporation has Subchapter C earnings and profits at the close of any year beginning after December 31, 1981 and if more than 25 percent of its gross receipts in any such year consists of passive investment income, then § 1375 imposes a tax on such "excess net passive income."

Determining the amount of the corporation's "excess net passive income" is done first by computing the amount of its net passive income, that is, the

amount of its passive investment income reduced by all allowable deductions directly connected with the production of that income, other than any net operating loss, the dividends received deduction, and certain other deductions. The corporation's excess net passive income then is that percentage of its net passive income obtained by dividing the excess of the corporation's passive investment income over 25 percent of its gross receipts by the total amount of its passive investment income.[26] The tax imposed on this excess is at the highest corporate rate, currently 46 percent. No credit other than that available under § 39 may be applied to reduce the tax on excess passive income.

Conversions Between C and S Corporations

No carryforward or carryback arising while a corporation is a C corporation may be carried to any year in which the corporation has a Subchapter S election in effect.[27] However, each year for which the election is in effect, except the S short year resulting from a termination of the election, will be counted for purposes of determining the number of years to which any item arising while the corporation is a C corporation may be carried forward or back.[28] Since all items arising while a corporation is an S corporation pass through to the shareholders, there is no carryforward or carryback from any year in which it is an S corporation to any year in which it is a C corporation.[29]

The Act specifically provides that an election to S corporation status will be treated as a mere change in the form of conducting the business. However, the S corporation will continue to be subject to recapture for early dispositions of investment tax credit property acquired prior to its election.[30]

PART IV: TAX TREATMENT OF SHAREHOLDERS

Pass Through of Items

In determining the individual tax liability of each shareholder, each shareholder must take into account his or her pro rata share of the corporation's items of income, loss, deduction, or credit which, separately stated, could affect that individual's tax liability.

These separately stated items correspond precisely to the items required to be stated separately by the S corporation in computing its taxable income. Examples of such separately stated items include gains and losses from the sale or exchange of capital assets, § 1231 gains and losses, charitable contributions, tax-exempt interest, items involved in the determination of the investment tax credit and other credits, foreign taxes eligible for deduction or credit, foreign income and loss, and any other item which could result in a different tax liability if taken into account separately than if it were not.[31] In other words, the separately stated items are all those items that are subject to some limitation, condition, or other special treatment such that their treatment in the hands of one shareholder might differ from that in the hands of another.

In addition, each shareholder is required to take into account his or her "nonseparately computed income or loss" of the corporation, that is, a pro rata share of the corporation's income or loss that has no special character and is not required to be separately stated.[32] A shareholder's pro rata share of corporate items is determined on a per-share, per-day basis.[33] Such a pro rata allocation, however, may not accurately reflect the actual financial circumstances of the corporation throughout the year, which becomes particularly relevant in the context of a termination of the corporation's Subchapter S election or the transfer of stock. Accordingly, if any shareholder terminates his interest during the year, and if all shareholders in the corporation during that year so consent, each shareholder's pro rata share of all corporate items may be determined by treating the corporation's taxable year as having closed on the day the shareholder's interest terminated.[34] If this is the case, then pro rata shares will be determined with reference to the items of income, loss, and the like actually reflected on the corporation's books for the applicable two (or more) short periods of the taxable year.[35]

Although the Act's conduit or pass-through treatment of all corporate items closely conforms to that applicable to partnerships, its per-share, per-day system of allocating those items among shareholders (or the closing of the books alternative) lacks one exceptionally flexible feature available only to partnerships. Assuming the allocation has "substantial economic effect," a partnership may provide for special or disproportionate allocations of various items among its partners. An S corporation, therefore, may not be a suitable vehicle for structuring a tax sheltered investment opportunity, where special allocations of losses, deductions, and credits are intended to attract high bracket investors.

Modifications to Pass Through of Items

The Act contains several limitations on and modifications to the rule that all corporate items flow through to and are reported by the shareholders on a per-share, per-day basis. First, the IRS possesses the power to make whatever adjustments may be necessary to reflect the value of services rendered or capital contributed to an S corporation without adequate consideration by any member of the family of a shareholder.[36] Under prior law, the IRS could make adjustments only to reflect the proper value of services rendered to the corporation by its shareholders. Moreover, unlike partnership tax rules, the Act may authorize the IRS to disregard a valid gift of a capital interest in the corporation.[37]

Second, any tax paid by the corporation on its capital gain income under § 1374 or the minimum tax provisions will reduce first the amount of long-term capital gains other than § 1231 gains and then the amount of § 1231 gains passed through to the shareholders,[38] and the tax paid on any passive income will proportionately reduce each item of the corporation's passive investment incomes.[39]

Third, the amount of losses and deductions that may be taken into account by any shareholder is limited to the sum of the shareholder's adjusted basis in stock in the corporation and adjusted basis in any indebtedness owed by the

corporation to the shareholder. For purposes of this limitation, any adjustments that increase the shareholder's basis in his stock for the year are first made, but adjustments that restore the shareholder's basis in any indebtedness are not.[40] Any loss or deduction that is disallowed by virtue of this limitation may be carried forward indefinitely until such time as the shareholder has sufficient basis in stock or indebtedness to absorb it.[41] However, if the S corporation's election terminates, any disallowed but carried forward loss or deduction will be treated as incurred on the last day of the "post-termination transition period," when it may be taken into account to the extent of the shareholder's basis in stock in the corporation on that day.[42]

The at risk rules of § 465 impose a final limitation on the deductibility by shareholders of losses incurred by S corporations engaged in a trade or business or the production of income. In a general partnership, an individual partner's amount that is considered to be at risk can be increased by the extent to which that partner's basis in the partnership is increased proportionately under § 752 due to loans by the partner or recourse loans by third parties to the partnership.[43] In contrast, the full amount loaned by a shareholder to an S corporation, adjusted to reflect increases or decreases in the basis of the indebtedness, should be considered at risk, but loans by third parties will not increase the shareholder's amount at risk.[44]

Basis Adjustments

Under the Act, a shareholder's basis in stock of an S corporation is increased by (1) separately stated items of corporate income passed through (as opposed to paid out) to the shareholder, including tax-exempt income, (2) nonseparately computed income passed through, and (3) the excess of deductions for depletion over the basis of property subject to depletion, and decreased by (1) certain corporate distributions not includable in the shareholder's income, (2) separately stated items of corporate loss and deduction passed through to the shareholder, (3) nonseparately computed loss, (4) any corporate expense that is not deductible in computing taxable income and is not properly chargeable to capital, and (5) the amount of the shareholder's deduction for depletion with respect to oil and gas production.[45] A provision allows a shareholder to increase his stock basis on account of items required to be included in the shareholder's gross income only if those items are in fact reported on his return as income or included in his income by virtue of any subsequent redetermination of his tax liability by the IRS.[46]

A shareholder's basis in loans to an S corporation will be reduced only if the items which decrease the basis of stock (except nontaxable distributions) exceed his stock basis. To the extent there is a net increase in any succeeding taxable year of all of the basis adjustments, that increase will restore the basis of any debt, before any increase in stock basis will be made.[47]

Distributions to Shareholders

The tax treatment of a distribution from an S corporation will vary depending on whether the corporation has accumulated earnings and profits. If

an S corporation has no accumulated earnings and profits, corporate distributions are treated as a tax-free return of capital, to the extent the distribution does not exceed the shareholder's adjusted stock basis. If the amount of the distribution exceeds the recipient shareholder's stock basis, that excess is treated as gain from the sale or exchange of property.[48]

A distribution by an S corporation with accumulated earnings and profits is treated as a tax-free return of capital and is not included in the shareholder's gross income to the extent that the amount of the distribution does not exceed the corporation's "accumulated adjustments account." The portion of the distribution in excess of the accumulated adjustments account is considered a dividend to the extent of the corporation's accumulated earnings and profits. Any remainder is treated as a return of capital to the extent of the shareholder's adjusted basis of the stock and as gain from the sale or exchange of property to the extent of any excess.[49]

The corporation's "accumulated adjustments account" is defined as an account that is adjusted for periods after December 31, 1982 to reflect corporate income and loss in a manner similar to the adjustments made to an S corporation shreholder's basis. However, no adjustment to the accumulated adjustments account is made to reflect tax-exempt income or any nondeductible corporate expense not properly chargeable to capital account. In other words, the accumulated adjustments account for any S corporation is essentially that corporation's accumulated gross income less deductible expenses not previously distributed to its shareholders.[50] The accumulated adjustments account thus allows shareholders to defer indefinitely the taxation of corporate distributions attributable to accumulated earnings and profits.[51]

If an S corporation distributes property having a fair market value in excess of its adjusted basis in the hands of the corporation, the distribution will be treated as a sale or exchange. As a result, the corporation will recognize gain on the distribution which will pass through to the shareholders.[52] The distribution could also trigger a corporate level tax on the gain under Sections 1374 or 1375 and result in recapture of investment tax credit and cost recovery deductions.

A special transitional rule preserves the character of the undistributed taxable income of a Subchapter S corporation in existence before the effective date of the Act, so that certain distributions of previously taxed income after 1982 may occur tax-free and will not be subject to the distribution rules.[53]

PART V: OTHER RULES

Related Party Transactions

Section 267 generally disallows a deduction for certain expenses accrued by a corporation and owed to a related party on the cash basis of accounting, such as a bonus to be paid to a shareholder-employee, if the expense was not paid within two and one-half months after the close of the corporation's taxable year. For these purposes, a corporation and a shareholder who owns,

after the application of certain constructive ownership rules, more than 50 percent of the corporation's stock are considered related.[54]

The Act created a special rule for the deductibility of unpaid expenses and interest owed by an S corporation to certain shareholders and persons related to such shareholders. Under this rule, any person who directly or indirectly owns 2 percent or more in value of the outstanding stock of an S corporation, together with any person related to such a shareholder within the meaning of § 267(b) or § 707(b)(1)(A), will be deemed related to the S corporation. If the shareholder or any other related person is then on the cash method of accounting, so that amounts are not included in gross income until paid, then the S corporation is not allowed a deduction for any business or interest expense owed to the shareholder or related person until the day a corresponding amount is includable in the gross income of the person to whom the payment is made.[55] In other words, the Act matches the timing of the corporation's deduction, which is carried through to the shareholder's return, with the reporting of the shareholder's income. While a C corporation will be allowed a deduction for the year of accrual if payment is actually made within the following two and one-half month period, Section 267 converts a Subchapter S corporation into a cash basis taxpayer, so that the deduction is allowed only in a later year when payment is made.

The Act also amended § 267(b) to specify that an S corporation and certain other entities will be considered related for purposes of the normal § 267 disallowance rules. These other related entities will include a partnership if the same persons own more than 50 percent in value of the outstanding stock of the S corporation and more than 50 percent of the capital or profits interest in the partnership; another S corporation if the same persons own more than 50 percent in value of the outstanding stock of each S corporation; and a C corporation, if the same individual owns more than 50 percent in value of the outstanding stock of the S corporation and the C corporation.[56]

Employee Benefits

The Act amended § 1372 to provide that an S corporation will be treated as a partnership for purposes of all employee fringe benefits and that any 2 percent shareholder will be treated as a partner in the partnership, rather than as an employee.[57] For this purpose, any person who owns, directly or indirectly through the attribution rules of § 318, more than 2 percent of the stock of the S corporation or stock possessing more than 2 percent of the total combined voting power of all stock of the corporation on any day during the corporation's taxable year will be regarded as a 2 percent shareholder.[58]

Because of these rules, a 2 percent shareholder will not be entitled to the § 79 exclusion for the cost of up to $50,000 of group-term life insurance, the § 101(b) exclusion for the first $5,000 of employer-paid death benefits, the § 105 exclusion for amounts paid under a health and accident plan, the § 119 exclusion for meals and lodging furnished for the convenience of the employer, or the § 124 exclusion for the value of commuter transportation furnished by the employer.

The 2 percent shareholder fringe benefit rules are generally effective for years beginning in 1982, except that they become effective in years beginning after 1987 for existing fringe benefit programs of corporations that had elected Subchapter S status by September 28, 1982. This "grandfather" protection afforded to existing corporations will terminate upon the earlier of the first day of any year after 1982 in which the corporation fails to meet the 20 percent passive income test of prior law, the date of the termination of the corporation's election, or the first day on which more than 50 percent of the corporation's stock becomes "newly owned."[59]

FOOTNOTES TO CHAPTER 21

1. Pub. L. No. 97-354 (1982).

2. The Act discarded the familiar term "Subchapter S corporation" and instead formulated a distinction between what are now called "S corporations" and "C corporations," the latter being defined as any corporation that is not an S corporation.

3. IRC § 1361(b).

4. IRC § 1361(c)(4).

5. See Chapter 15.

6. IRC § 1361(c)(5)

7. IRC § 1362(a), (b).

8. IRC § 1362(d)(1)(B).

9. IRC § 1362(d)(1)(C).

10. IRC § 1362(d)(1)(D).

11. IRC § 1362(d)(2).

12. IRC § 1362(d)(2)(B).

13. IRC § 1362(f).

14. IRC § 1362(e)(1).

15. IRC § 1362(d)(3).

16. Id.

17. IRC § 1362(g).

18. IRC § 1378(a), (b).

19. IRC § 1378(c).

20. IRC § 1363(b).

21. Id. The deductions not allowed include deductions for personal exemptions, foreign taxes, charitable contributions, net operating loss, the additional itemized deduction for individuals, and the depletion deduction.

22. IRC § 1363(b)(3).

23. IRC § 1366(b).

24. IRC § 1363(c)(1).

25. IRC § 1363(c)(2).

26. IRC § 1375(b).

27. IRC § 1371(b)(1).

28. IRC § 1371(b)(3).

29. IRC § 1371(b)(2)

30. IRC § 1371(d).

31. IRC § 1366(a)(1)(A).

32. IRC § 1366(a)(1)(B), (a)(2).

33. IRC § 1377(a)(1).

34. IRC § 1377(a)(2).

35. The legislative history indicates that the IRS will examine the corporation's "permanent records," including work papers, to determine the proper allocation.

36. IRC § 1366(e).

37. Compare IRC § 704(e)(1) (person recognized as partner where capital interest acquired by gift).

38. IRC § 1366(f)(2).

39. IRC § 1366(f)(3).

40. IRC § 1366(d)(1).

41. IRC § 1366(d)(2).

42. IRC § 1366(d)(2).

43. Prop. Treas. Reg. 1.465-7.

44. See Prop. Treas. Reg. 1.465-10. Since taxable income and loss are not determined by the S corporation, the at risk rules apply only at the shareholder level. IRC § 465(a).

45. IRC § 1367(a). This basis rule mirrors that of partnerships. See IRC § 705.

46. IRC § 1367(b)(1). There is no similar partnership rule.

47. IRC § 1367(b)(2)(B).

48. IRC § 1368(b).

49. IRC § 1368(c).

50. IRC § 1368(e)(1); Senate Report at 20.

51. Deferral is limited, however, if the corporation incurs a significant amount of tax-exempt income, since the accumulated adjustments account is not adjusted for such income.

52. IRC § 1363(d).

53. IRC § 1379(c).

54. IRC § 267(b)(2).

55. IRC § 267(f).

56. IRC § 267(b)(10)-(12).

57. IRC § 1372(a).

58. IRC § 1372(b).

59. Pub. L. No. 97-354, § 6(d)(2).

CHAPTER 22

BARGAIN LEASES FROM BANKRUPT TENANTS

The dramatic upward spiral of commercial rent costs has elicited the concern of businesses and professional firms. Indeed, The New York Times recently reported that seven major New York City law firms were considering forsaking the flower-bedded vistas of Park Avenue and relocating to the Times Square area, currently the preserve of many acting beyond the pale of the law. The rationale behind this surprising possibility boils down to a question of dollars and cents. Even giant law firms find it nearly impossible to absorb rental rates of $50 to $100 per square foot. Nor are they alone. In many cities, established retailers and industrialists and those considering opening new locations are often struggling in the grip of the increasing downtown and shopping center rental rates.

Little-understood but profitable opportunities for picking up below-market rental space (office, industrial, and shopping center) are presented by the proliferation of bankruptcy filings under the recently enacted Bankruptcy Code (which applies to all bankruptcy cases begun since October 1, 1979). In 1982 and 1983, hundreds of companies sought relief under the Bankruptcy Code. Lease opportunities are abounding because many of those bankrupt companies can choose to assign to other companies their rights as tenants, despite any defaults, despite their landlords' objection, and despite the existence of lease clauses which prohibit assignments without the landords' consent.

Shrewd business persons who understand the relevant provisions of the Bankruptcy Code can obtain leases at the bargain-level rental rates of a few years ago. Able entrepreneurs have capitalized on the provisions of the Bankruptcy Code that relate to assignments and have saved millions of dollars in reduced rental rates. A classic example is offered by the Silverbird Hotel in Las Vegas, which recently went bankrupt and sold its fifteen-year leasehold interest to the highest bidder.

THE BANKRUPTCY PROVISIONS

Companies which avail themselves of the "safe harbor" provided by the Bankruptcy Code usually attempt to reorganize and negotiate plans that will permit them to repay (at least in part) their creditors' claims. Other troubled companies determine before filing their petition (or some time later) that they cannot reorganize successfully. These companies are liquidated pursuant to the Bankruptcy Code under the auspices of a trustee and under the scrutiny of the bankruptcy court.

Whether they reorganize or liquidate, debtor companies frequently phase out certain of their leased locations. A reorganizing debtor typically decides that in order to survive, the company must close down or sell segments

of its business. For example, in the City Store's reorganization, the company concluded that it could not afford to maintain its Franklin Simon and Richards store operations in various states. City Stores put most of those stores on the bankruptcy court auction block, raised cash for itself and its creditors, and, in the process, offered alert buyers a bonanza.

On the other hand, in a bankruptcy liquidation, the company decides to close or sell everything. All the operations of the debtor-company are terminated and sold if they are valuable. An example is the case of the enormous conglomerate, United Merchants and Manufacturers. That debtor company decided to terminate its Robert Hall division and actually sold many of the stores. The opportunities for the acquisition of cheap leaseholds were so good that disappointed bidders sometimes sued the buyers to try to recover a piece of the action.

How much is a debtor's leasehold worth? Many long-term leases, if they can be assigned to a third party, could be worth a bundle. One debtor sold one-half of a twenty-five-year lease for a manufacturing plant (with a ten-year renewal option) for $230,000. The rent of $.81 per square foot was $2 per square foot less than market, according to the bankruptcy court a "$1 million asset" for the fortunate acquirer.(1)

Without a bankruptcy filing, these leasehold bargains would be lost to all but the landlord. Specifically, most leases contain provisions which prohibit the tenant from assigning its rights under the lease without first getting the landlord's written consent. Obviously, no reasonable landlord will waive a "nonassignment" clause voluntarily and agree to permit a tenant to assign its rights under a long-term lease that has, say, ten years left to run at rental rates that prevailed some time ago, if he has a shot at recovering the premises and reletting them at current, sky-high rates.

Moreover, prior to the new bankruptcy law, landlords could and usually did argue that a bankrupt tenant's lease had terminated because of the tenant's bankruptcy. Under the act that was repealed by the present Bankruptcy Code, landlords were able to use so-called bankruptcy forfeiture clauses to terminate their debtor-tenant's long-term leases. These clauses were boiler-plate provisions that said, in effect, that the bankruptcy of the tenant was a default under the lease that permitted the landlord to start eviction proceedings. Landlords litigated constantly because of the windfall rewards that higher rental rates promised. At a minimum, they were able to obtain a settlement that gave them a piece of the windfall.

Under the terms of the new law, Congress recognized that long-term leases may often constitute treasure troves for companies in bankruptcy which should be both preserved and assignable. Consequently, the provisions in the new Bankruptcy Code generally emasculate bankruptcy termination clauses and invalidate lease anti-assignment provisions.

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Bankruptcy Termination Clauses are Unenforceable

Section 365(e)(1) of the Bankruptcy Code declares that lease provisions which permit the landlord to terminate his tenant's leasehold upon his tenant's bankruptcy or insolvency are unenforceable. Furthermore, even if the debtor had defaulted before or during bankruptcy and the landlord had started eviction proceedings, the Bankruptcy Code now allows the debtor to cure the earlier defaults and remain in possession of the property. For example, one reorganizing debtor merely had to pay two months' rent, real estate taxes, and labor rate escalation obligations in order to cure its default and take advantage of a lease.(2)

Bankrupts' Rights to Assign Their Leases

Congress also clarified and modified the previous law relating to lease anti-assignment provisions. Possibly because Congress had eliminated landlords' rights to snuff out a lease because of the tenant's bankruptcy, and because Congress wished to remain evenhanded, the Bankruptcy Code contains elaborate provisions governing the assumption and assignment of unexpired leases.

Generally, a debtor must assume an unexpired lease before assigning it. That is, the debtor must say, in effect, that it wants to honor the lease and keep using it (assume it), but it may then try to transfer the leasehold interest to another person (assign it). Indeed, at least one bankruptcy court has held that the debtor may assume the lease and then sublease it. In the case of Lafayette Radio Electronics Corp., Lafayette's sublease would bring it earnings of $880,000 over the twelve-year term of the lease.

Specifically, under Section 365(f) of the Bankruptcy Code, a debtor-tenant or its bankruptcy trustee may assign its rights under a lease despite any lease provision that prohibits the tenant from making such an assignment without the landlord's consent.

In order to assume and assign the lease, the defaulting tenant must fulfill two conditions:

> The tenant-debtor or its trustee must cure (or convince the bankruptcy court that it will cure) any existing lease defaults and compensate the landlord for his expenses caused by the defaults; and
>
> The proposed assignee under the lease must be shown capable of providing "adequate assurance" that it will comply with all the terms of the lease.

The first condition means that the tenant must pay back rent that is due, make repairs, or correct whatever defaults had taken place, as well as reimburse the landlord for its attorneys' fees and other pecuniary losses. This is a fairly straightforward requirement.

The requirement that the proposed assignee show adequate assurance presents thornier problems. The bankruptcy courts have generally found the

condition satisfied if the proposed assignee of the lease demonstrates that it has the financial wherewithal to make the necessary payments required under the lease and that it will comply with any "use" clauses of the lease which the landlord can show would cause actual and substantial detriment if the assignee did not comply with them.(3) (For example, if the specified "use" of the premises is a retail department store, the premises would then have to be used as such a store.) Bankruptcy judges realize the value of leases for debtors and sometimes bend over backward to find that an assignee is suitable. For example, in the Duplan Corp. Chapter X case under the old Bankruptcy Act, the assignee was a subsidiary of the Chapter X debtor.(4) The landlord objected to the proposed assignment on the grounds that the proposed assignee did not appear to be able to make the payments required under the lease. The court held that the proposed assignee possessed the statutory financial means despite the fact that it had lost substantial sums of money during each of the four previous years and that its most substantial asset was a whopping tax loss carry-forward.

Special Protection for Shopping Center Landlords

It is an interesting sidelight that shopping center landlords enjoy unique protections by reason of special provisions for shopping center leases in the law. Because owners and developers of shopping centers foresaw the effect that Section 365 would have on their ability to control the financial strength and tenant mix at their shopping centers, they lobbied strongly and persuaded Congress to add special provisions in their favor.(5) Under Section 365(b)(3), a debtor-tenant or its trustee may assume and assign its leasehold rights under a shopping center lease. However, the section imposes conditions in addition to the conditions of "cure and assure" that are imposed upon the ordinary assumption and assignment. The potential assignee of a shopping center lease must provide "adequate assurance" for the following:

> He must show the source of the rent and any other sums due under the lease;
>
> He must demonstrate that any percentage rent due under the lease will not decline substantially;
>
> He must show that assumption or assignment of the lease will not substantially breach any provision, such as radius, location, use or exclusivity provisions, in any other lease, financing agreement, or master agreement relating to such shopping center; and
>
> He must show that assumption or assignment of the lease will not disrupt substantially any tenant mix or balance in such shopping center.

Thus, shopping center landlords are protected when their leases are assigned or sublet, because the new lessee must generally fill the shoes of the earlier tenant that went bankrupt.

THE BANKRUPTCY PROCEDURES

The purpose of this chapter is to stimulate awareness of the bankruptcy opportunities discussed above. It therefore does not attempt to examine in detail all the legal steps that may be involved. Obviously, taking advantage of the leasehold opportunities provided by bankruptcies requires legal advice from someone familiar with bankruptcy procedures.

However, the concepts are relatively simple. If you want to obtain a favorable lease, you need to negotiate with the debtor regarding the terms of the purchase and compliance with the lease and bankruptcy limitations. Next, the debtor will probably give notice to its creditors, and perhaps other potential bidders, of the deal you have struck and give them an opportunity to object to the terms, or to better your bid, at a bankruptcy court hearing. Sometimes this process can be accelerated by the use of an order to show cause which shortens the period parties have to respond. If no one objects, or if the court overrules such objections, the lease and its old-fashioned rates are yours.

No official bankruptcy rules have yet been promulgated governing the procedures either for bankruptcy court approval of a lease assumption or for assessing whether adequate assurance of future performance has been provided. Most bankruptcy courts treat each situation on its own merits.

SOME CASE HISTORIES

Many examples exist of the dramatic benefits that the bankruptcy law can bestow on those who are alert. In one gargantuan sale in May 1981, National Shoes, Inc. auctioned in the bankruptcy court forty-six leases of its stores in seventeen states. National Stores earned more than $997,000 from the sale of these leases. One can only imagine the profitability of the leases to the purchasers. In another Chapter 11 reorganization case, THH Corporation sold a five-year lease for a warehouse for over a quarter-million dollars. Two months later, another debtor, Jewel Terrace Corp., sold two leases to properties containing prime apartment buildings in New York City for more than $4.8 million.

Among the best-known sales, because they received media attention, are the sales by Korvettes, Inc. of its properties, primarily in the New York metropolitan area. Thus far, sales of those leaseholds containing rental value far below prevailing rates garnered more than $10 million. Food Fair, the former supermarket chain, sold off dozens of leases in the Baltimore area for more than $20 million. Finally, Seatrain Lines, Inc. offered in its bankruptcy case its ground lease and purchase option for twelve acres of prime land in New Jersey.

Although in each of these examples, and in bankruptcy cases generally, the debtor's intention is to realize the maximum amount possible from the assignment, the debtor must nevertheless offer bargains because of the conditions under which the sales are made and the debtor's need for cash.

In a time of soaring rentals, the opportunities to take over preinflation leases of bankrupt companies at down-to-earth prices deserve careful scrutiny.

The bargains are there if you seek them, thanks to the flexible provision. changed law of the new Bankruptcy Code.

Footnotes:

(1) In re Sapolin Paints, Inc., 5 B.R. 412 (E.D.N.Y. 1980).

(2) In re Lafayette Radio Elec. Corp., 9 B.R. 993 (E.D.N.Y. 1981).

(3) In re U.L. Radio Corp., 19 B.R. 537 (Bankr. S.D.N.Y. 1982).

(4) In re Duplan Corp., 473 F. Supp. 1089 (S.D.N.Y. 1979).

(5) In this regard, it is interesting to note that on or about March 5, 1982, the International Council of Shopping Centers presented to the U.S. Senate Committee on the Judiciary's Subcommittee on Courts certain proposals which if enacted would even further enhance the position of shopping center landlords under the Bankruptcy Code, particularly in the area of lease assignments.

(This chapter appeared as an article in the Real Estate Review.)

CHAPTER 23

PROPOSALS OF THE NATIONAL ADVISORY COUNCIL OF THE SMALL BUSINESS ADMINISTRATION

The last edition of this Guide summarized the first meeting of the National Advisory Council of the Small Business Administration ("SBA"). The Council is charged with advising the SBA Administrator of ways of improving the effectiveness of national small business policy and acting as a channel of information between the SBA and the small business community.

Many of the resolutions passed by the Council during that first meeting and subsequent meetings have been enacted into legislation or administrative regulations which have enabled small businesspersons to do what they do best--produce goods and services and new jobs.

The Fall 1983 meeting of the Council was equally productive. High ranking officials of SBA, including Administrator Sanders, Chief Counsel for Advocacy Swain and Deputy Administrators Herrera, Parker and Turnbull, described the current priorities of SBA such as encouraging business ownership by women and veterans and promoting international trade. The Reagan Administration reaffirmed its commitment to provide equal access and opportunity for women entrepreneurs through the establishment of the Presidential Advisory Council on Women's Business Ownership, the Interagency Committee on Women's Business and the National Women's Initiatives Conference. The latter program will sponsor 22 major conferences and workshops for women to improve their business skills. SBA will emphasize international trade through the theme "exporting can put the world in your pocket." SBA will also assist veterans by sponsoring Veteran's Busienss Ownership Conferences and forming the SBA Veterans Advisory Council.

The Council passed approximately 80 resolutions which have been submitted to tne Administrator for action. Some of the more significant resolutions are summarized below.

The Council Recommends That

1. The Davis-Bacon Act, which calls for government construction contractors to pay the prevailing wage in the area of construction, be repealed.

2. A study be initiated to study the effects of the Employee Retirement Income Security Act ("ERISA") on small business.

3. A representative of small business be appointed to any federal task force formed to study social security and multi-employer pension reforms.

4. Approval time on SBA loans be shortened.

5. Loan guarantees of less than 90% be allowed on loans of $100,000 or less.

6. Guaranty limits on SBA loans be increased to $1,000,000.

7. SBA support training programs for officers involved in the SBA loan program.

8. A program be immediately initiated to find ways to encourage greater investment in small business.

9. SBA support a pilot program for a revolving line of credit for small business.

10. SBA develop a Model State Paperwork Reduction Act to assist states in reducing the paperwork imposed on small business.

11. Each SBA field office be staffed with qualified export specialists.

12. Legislation be supported which would allow a 10 percent export credit on new export sales of $1 million or less by small business.

13. Small Business Development Centers in agricultural regions place greater emphasis on programs that would educate farmers in economics.

14. The resources of the Minority Business Development Agency ("MBDA") be transferred to SBA.

15. The Small Business Innovation Research Program, which calls for small business set-a-sides of a portion of government research grants, be supported and promoted.

16. A federal product liability law which does not create substantive changes to workers' compensation systems be adopted.

17. A uniform limited offering exemption should be adopted by the states.

18. The effect of a "unitary tax" on small business be studied.

19. A general payroll tax credit to small businesses that increase the number of employees be implemented.

20. Small businesses be allowed to borrow up to $250,000 from qualified profit-sharing plans to which they have made a contribution.

21. SBA increase the awareness of assistance program for veterans.

22. SBA prepare a national public information campaign directed to banks and women business owners which would inform lenders and applicants of their rights and responsibilities.

President Reagan and his top aides have met with the Council at our past meetings and their commitment to the American small businessperson remains strong. They believe that growth can only be realized through a strong small business sector of our economy and are working hard to achieve this goal. All small businesspersons, especially women and veterans, are urged to contact their local SBA field office for assistance in either starting or expanding a business.

Historical Data

Services Provided
Period of
December 16, 1980 through December 31, 1983

Deliverable	12/16/80 to 12/31/81	1/1/82 to 12/31/82	1/1/83 to 12/31/83	1983 % of Increase over 1982
I. Counseling:				
-Inquiries*	24,095	36,748	74,293	108%
-Short-Term	3,794	7,015	8,624	23%
-Long-Term (12 or more hours)	627	647	694	8%
-Minorities		1,416	1,632	16%
-Exporters		93	63	-33%
-Total Hours	43,601	55,888	58,632	5%
II. Training Programs:				
-Workshops	84	97	98	1%
-Courses	42	57	70	23%
-Conferences	175	263	364	39%
-Veteran Attendees			4047	
-Minority Attendees		1,320	2428	84%
-Exporter Attendees		664	868	31%
-Total Number of Attendees	8,993	11,788	17,656	50%
-Total Training Hours (Lecture time x attendees)	55,290	63,369	87,700	39%
-Actual Lecture Hours			2,605	
III. Speaking Engagements*	181	206	260	27%
-Attendees	5,258	7,679	10,477	37%
IV. Federal Funds Expended	$923,486	$1,249,516	$1,559,224	25%
V. Federal Cost Per Hour of Assistance	$9.34	$10.48	$10.66	2%

*Not included in cost figures

Attachment "E"

Mr. NEAL SMITH. Next?

TESTIMONY OF LARRY R. BRAMBLETT, FORMER DIRECTOR, GEORGIA SMALL BUSINESS DEVELOPMENT CENTER, AND PRESIDENT, M.A.G., INC.

Mr. BRAMBLETT. Thank you, Mr. Smith.

I am Larry Bramblett. I am appearing today in my capacity as former director of the State of Georgia Small Business Development Center program.

Also, I was formerly president of the National Small Business Development Center Association. Currently, Mr. Chairman, I'm operating my own small business and serving as chief executive officer in that capacity.

I served approximately 5 years assisting in the development of the Georgia program and today can say as a small businessman that the State of Georgia, and with a new hat on, the State of Georgia and the small business community of Georgia feel that this program is very much necessary in Georgia for economic development and to continue to sustain economic development.

I want to go on record to tell you, Mr. Smith and Mr. McDade, that we certainly appreciate from the business community of the State of Georgia, and from the State government side of the coin and from the higher education side of the coin the sustained contributions which you have made over the last 4, 5, 6, or 7 years to this activity.

If it were not for you two and a couple of other people on the Senate side, then we certainly know that this program would be a faded dream by now.

I have a statement which I certainly do not intend to read into the record but it's here for your use. I would rather from a historical, if you will, a Monday morning quarterback type position, talk about a few things that I think you might want to take a look at, both pro and con, with respect to what these hearings are about today.

First of all, I must say that the legislation which was designed is for the most part excellent legislation. You have provided a framework in which States can do their own thing, yet within a framework that they're guided by national policy.

Beyond that, I would suggest that you consider wording in your legislation to the extent that the funding formula is working, the 50–50 match is working, then the SBDC should have autonomy. If the local entities are not willing to pay the piper, then they should not get to play the game. I strongly believe in that.

On the other hand, the problem that I had as director and I understand it has improved somewhat but not extensively, was that we never knew how much or when we were going to get money.

The funding from the SBA would come in, possibly come in, 3 months, 2 months, 6 months, 9 months after.

I would suggest that you consider some sort of amendment to the legislation some cycle, some cutoff be established to give the SBA a goal of notifying the institutions and participants of the time in which they must receive or will receive funding and actually the amount that they will receive.

Now obviously for planning purposes and from a business perspective it would be very good the longer that or the further out in the future that deadline is, such as 6 months, 12 months or so, would be most appropriate.

Without that I do not think, and I'm not criticizing the current administration, but without that I do not feel that the agency or any agency can establish goals without some mandate, some charge, from Congress.

The second thing that I would like to mention is that it's obvious that the Small Business Development Center's bread and butter, if you will, is management counseling and continued education assistance. The numbers that I see from my colleague here from Georgia are almost staggering. They're increasing at an astronomical rate and I would suggest to you that those bread and butter activities were not being covered prior to this program or there would not be that much demand for them.

What I'm about to say is that the legislation should provide for a significant amount of continuation in that area, but I strongly suggest, too, that with a blend there, you allow these people to do some specialized activities but not forgetting the fact that the management assistance and the counseling and the continuing education portion of the original legislation was the overriding factor that was in the minds of those that originally structured the wording.

The second thing that I would like to point out that I as the SBDC director did not conceive was another contribution that this program is making. It's raising the general awareness level of small business and various entities in the State legislatures, in the Governor's office, at other institutions of higher education and higher learning, post secondary and vocational schools.

The only comment that I could make is that that should be continued. I can cite examples. It is also raising the awareness level in the larger corporations, such as Fortune 500 organizations, that they should be involved with and working with, and I will cite one there.

The International Association—and by the way, this is the only work that I have done with the center since I left almost 2 years ago.

The International Association of Minority Business Schools is a spinoff from the SBDC. They are historically black, 103 institutions in the United States. Approximately 40 of those desired to create a program which would provide a computer program their small business students and their small businesses they were counseling—by the way, the IABI program.

The idea of this program was to create a computer literacy on the part of minority small businesses and also minority students at minority institutions and business schools.

We were able to work with that group as a private institution which was initiated by SBDC with a Fortune 500 corporation, which that corporation donated significantly heavy equipment, and also donated training and so forth and so on.

This is a kind of an awareness thing that you see going on throughout America and had not this program been housed in universities or institutions that have high credibility, it would not

have had the clout or the credibility to pull off a project such as the one that was the trust factor there. That added tremendously to that.

With respect to three or four things that I think I need to close with, in terms of recommendations or suggestions that you review, other than the funding situation in terms of the cycle, I would suggest that there is always the question of evaluation.

Someone has to continue to review this program. We cannot let universities nor can we let any institution or agency in our society go unchecked.

I think you probably are going, if I may make a suggestion, with the checks and balance system. That is, I certainly would include in any checks and balance system a peer review.

Academia is a very competitive situation in which a peer is more critical than an outsider. Such is the case, by the way, with other professions, societies and law and medicine. Some of them seem to have regulated themselves or, if you will, judged themselves with a pretty good checks and balance system.

In terms of the ongoingness of that review and information to be provided by Congress and to be provided to the Small Business Administration, I would like to suggest that certainly the SBA perhaps has the capability to internally collect information on this program, but I would remind you that back in the mid-1970's we could not get reports out of the SBA. It didn't matter how you tried, and I guess I'm suggesting that the House take a close look at that information system and SBA's proposal to move it inhouse.

The one that's intact now, the SBDC's, is under contract and I'm not suggesting that that vendor that provides that contract service now be continued on, but the concept of effective internal daily management information must continue.

As a result, by the way, of this activity that was required by the Congress, that information is being used to manage these centers. As the program was kicked off I found that it was excellent managerial information to run a center.

The Small Business Development Centers need that information. If the SBA takes it away from them or does not enhance that information, then the SBDC's are going to have to replace that anyway and they're going to replace it with 50 cents of your Federal dollars and 50 cents of local dollars. So there's two sides to that street with respect to the informational system. One is how we're going to pay for it and two is, is it going to be independent of the other components of this program?

The final thing is the authority and the responsibility issue. I think this will continue to be an issue as long as this program goes on, just as it has been with other programs. There are two entities, and I hate to use this example but there are two entities putting money into the jukebox and they both have to pick the same song. This is going to have to be balanced in some way.

This program has outgrown or in many ways has matured to the extent that even the original authors of this legislation and myself, who ran the program in Georgia for 5 years, didn't envision. It is making contributions in so many diversified ways that this picking or selecting a song cannot be done at a local level by a local Federal officer.

It can be done at the central office level through discussion and debate. I realize you have to run a national program. The State also is a partner in this and private sector is a partner in this and so is higher education, so they know best, or I believe they know best how to accomplish at the local level what you want accomplished.

With that in mind, I would suggest that you take a strong look at your centralized approach that you've used in the past, not the daily running of the program but the basic decision process in respect to policies, new issues, new programs, and new directions.

I don't think that that can come from the district offices. It can filter up but it must filter back down if it's going to have a national impact and be used nationally.

The final thing, and I will stop with this, is I would wholeheartedly encourage the Small Business Administration to, as was enacted in the law, put into effect the clearinghouse, the information dissemination process regarding programs and projects going on in the various States.

There does appear to be in certain instances some reinventing of the wheel, having to spend the R&D twice.

This can be eliminated to a great extent by a massive programmatic, not evaluative but programmatic, information dissemination process, and with the automation technology that the agency has at its disposal and universities have at their disposal, this should not be very costly but should be cost effective, instead.

Thank you, Mr. Chairman.

[Mr. Bramblett's prepared statement with attachments follows:]

PREPARED STATEMENT OF LARRY R. BRAMBLETT, FORMER DIRECTOR, GEORGIA SMALL BUSINESS DEVELOPMENT CENTER, AND PRESIDENT, M.A.G., INC.

My name is Larry Bramblett. I am appearing today in my capacity as former director of the Georgia statewide Small Business Development Center (SBDC), as the first president of the Association of Small Business Development Centers (ASBDC), and now as a small business owner. The first part of my statement, which addresses the operating experience and philosophy of the program, is the most extensive. I will then give a brief overview of the Georgia SBDC, followed by a summary of the legislative and administrative needs of the program.

Before proceeding, I want to thank you, Mr. Chairman, for this opportunity to present my views. I also want to underscore at the outset our deep appreciation for your steadfast support of the program over the last several years. By our, I mean small business owners like myself and the SBDC directors of which I was a part for many years. You, Congressman Smith, Congressman McDade, and others, with your respective staffs, have been a genuine source of strength for all of us who are and have been involved in the program. Without the unfailing Congressional commitment to the program, the SBDC activity as we know it today would be but a distant memory. Small business would have been the obvious immediate loser with the program's demise as will be demonstrated later by the data to be presented.

Happily, of course, the SBDC program is alive and well. And as a result, not only did thousands of small businesses survive and grow and thereby help to maintain a competitive, free enterprise system, but jobs were preserved and new ones created, firms began exporting, corporate and personal tax revenues were increased, and many communities were immeasurably helped in their economic revitalization efforts.

At this juncture, I would like to give you a capsule summary of where we have been and where I think the program is headed. There are 23 SBDCs operating today in 22 states and the District of Columbia. Since 1978 the SBDCs have collectively affected the lives of thousands of small businesses located across the country.

In 1976 SBA solicited institutions in eight states to sponsor and operate what were then called "university business development centers." That name was later changed to correctly reflect the mission or focal point of the program small business. Seven years later, seven of those eight states continue to be SBDC participants. One has dropped out because the state could not obtain sufficient resources to match the federal dollars. Subsequently, 15 other states, plus the District of Columbia, have been admitted into the program. I understand that several other states are at various stages of admission and should be active participants provided the program is continued and there is sufficient federal funding to support a program expansion.

Regardless of projected future growth, there has evolved a small business extension service, which most interested parties at the state and federal levels now perceive as a permanent, ongoing program which has the capability and flexibility to meet the changing management and technical assistance needs of the small business community. In addition, this program has been the stimulus for other public and private small business development activities.

Initially, Congress, of course, envisioned there being a four year test period towards the end of which it would have to decide whether the enabling legislation, Title II of Public Law 96-302, would be made permanent. I mention this perception that the program is permanent in nature not to be presumptuous as I recognize the purpose of this hearing is to consider a measure eliminating the sunset provision, but to illustrate that the private and public sectors think in terms of this program as being here to stay. If the program was not meeting a vital need, if it was functioning as some ivory tower pontificator, such a subtle evolution in thinking would not have occurred.

Mr. Chairman, the SBDC program is first and foremost dedicated to providing management and technical assistance to prospective entrepreneurs and new and existing smaller businesses. But besides delivering this "bread and butter" type of assistance, it has caused the state legislative and executive branches of government to raise their level of consciousness towards a very precious, dynamic, and unique

resource within their states--small business! You in Washington are well acquainted with the virtues of the independent sector and its contribution to society and the economy, but surprisingly, only in the last few years have state officials come to the realization that smoke stack chasing of basic industries does not and will not alone make for stable, healthy local economies. An important ingredient called small business needs to be nurtured as well. It is in that regard that these officials have come to realize that the SBDCs are making an indispensible contribution in strengthening this primary job producing sector of the economy. This increased awareness has resulted in more state resources being dedicated and earmarked to specific small business endeavors such as SBDCs, the creation of small business committees within the state legislatures, the naming by governors of special small business assistants, the development of specific small business outreach programs by the departments of commerce or economic development, and in some instances, the organizing of either new statewide small business associations or small business divisions within existing generic based business organizations. In effect, the SBDCs have performed an unsung, undefined advocacy role on behalf of small business which is starting to pay big dividends. Regulatory, administrative, and legislative policies and programs are increasingly taking into account the perspective of small business, and I know the SBDCs have played a role in this phenomenon.

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As it turns out, Members of this Committee who were the original program proponents had some remarkable insights when you designed the legislative framework. You mandated that certain types of assistance should be rendered by each statewide SBDC, but at the same time, you clearly directed that each SBDC be organized in such a manner that it would respond to the unique needs of its own state or regions within that state. That charge has worked remarkably well. The delivery mechanisms that have been developed in one state are not necessarily appropriate in another state. Thus, one will find very distinct differences in how the SBDCs are organized, and the programs and resources they have developed--all to meet distinctively different client needs. For instance, innovation, trade, minority, women and industry specific outreaches have been developed--all of which are unique and different in each state. None were molded in Washington and then superimposed on each state center.

Another example of the SBDC's ability to respond to needs in a timely fashion was after the Small Business Innovation Development Act was signed into law, the majority of SBDCs took it upon themselves to not only inform the small business community about multi-agency SBIR programs, but to counsel small firms in how they might participate in one or more of those programs.

This last example provides a convenient illustration of a point I want to emphasize. The SBDC offers an abundance of resources to the small business person. And because the

SBDCs have to date been university based, the SBDC has both tremendous depth and breadth from which it can respond to virtually any client requirement. By serving as an umbrella entity, SBDCs have not had to create and dedicate capabilities for the exclusive and sometimes infrequent use for or by a small business client. Instead, they have established a network of resources both within and outside the university that can be called upon when the need arises. Examples of these various resources will be furnished when I speak to the operation in Georgia. Suffice it to say at this juncture that the SBDCs call upon faculty members and students within the engineering, law and business schools, as well as the other physical science departments when needed. Private consultants and professionals of all types, including myself, are used extensively both on a fee and volunteer basis.

And in that context, far from being competitive with the private management consultants, engineers and testing laboratories, as was feared when this Committee was holding hearings on the enabling legislation some years back, the SBDC program has proven to be an indispensible marketing tool for these professionals. The reason is the typical small business concern with whom the SBDCs become involved either cannot or believes it cannot afford a private consultant. However, once having had exposure to one of the SBDC centers, which independent studies indicate are overwhelmingly rated as being satisfactory, experience shows that the small business will more likely than not call on a private consultant when help is needed at a later date.

If the SBDCs had not originally interacted with the small business, the odds are the private consultant would not have later obtained that business as a client.

The Centers also work with professional and business related associations at the local, state and national levels. For example, the SBDCs have jointly published and distributed publications with the American Bar Association; have planned a pilot tax and accounting seminar program with a "big eight" national accounting firm; and are undertaking a joint venture to promote exporting with a regional small business organization. Several of the local SBDC offices operate out of trade association offices, such as the Chamber of Commerce. In Georgia alone, in 1983 over 300 private sector firms, trade associations, Chambers of Commerce and governmental agencies cooperated with the SBDC by cosponsoring programs, providing classroom space and serving as instructors and counselors.

Before leaving this subject there are two groups I would like to single out and publicly thank for their cooperation and assistance while I was a SBDC director. Both are part of the SBA sponsored "management assistance family." The first is the Small Business Institute Program (SBI) which involves students working for usually an entire semester on a small business case under the supervision of a faculty member. Small business owners have mutually benefitted as a result of these two programs working closely together. Students and small businesses are better matched, the problems to be addressed are better identified, and

there is more accountability for the work product delivered. As a matter of fact, everyone has found the relationship between SBDCs and SBIs so satisfactory that now in states with an SBDC, all SBI funds are being channeled through the SBDC system.

The other group deserving special recognition is SCORE. These retired volunteers who give of themselves so selflessly, play an increasingly important and indispensible role in our operations. In Georgia, one of the SBDC executives is an ex-SCORE member. He has been assigned the task of improving working relationships between SCORE and the SBDC. We believe that the major problems have been overcome.

Probably the most important development on the SCORE front is that new SCORE chapters are being formed and are affiliating with local SBDC offices. This means there is a net gain in the total number of SCORE chapters in the country. It also means increased expertise is being made available to start-ups and small companies at a very nominal cost to the taxpayer. In Georgia, a five-year goal has been set of having SCORE chapters with offices in SBDC facilities in each of the 12 district offices.

Lest I paint too rosy a picture, Mr. Chairman, I want to point out that the SBDCs have encountered problems. I would now like to take a few minutes to speak to what they were and how the SBDCs and the government have attempted to resolve them.

The major, overriding problem that permeated virtually everything we did from the inception of the

administratively started program in 1976 through 1982 was that SBDCs never knew whether their federal partner would have any matching dollars, and if it did, in what amount. In at least one year the administration had zero dollars budgeted for this program. As it turned out, almost nine million dollars was disbursed by SBA in that fiscal year.

This uncertainty reeked havoc in the program. States and academic institutions operate on a long lead time as does the federal government. At the expiration of a contract period to have SBA say it does not know what the next year's funding level will be or when it will be available causes both the state governments and the sponsoring institutions to become disillusioned with the program which in turn makes them less willing to increase their matching resources, or for that matter, maintain them at even current levels. In some cases, the agency notified schools that funding would be increased by a certain amount. Those schools immediately responded by hiring more personnel and initiating new functions. The agency later reversed itself, however, which then necessitated the termination of the newly hired personnel and the shutting down of programs recently begun, or continuing the program by borrowing from the University's general fund as was the case in Georgia.

A different but equally disruptive problem has occurred in each of the last several years. Once the funding level was finally agreed upon for the new twelve month funding cycle, supplemental funds were invariably made available provided they were spent within a time period as

short as three months. We (at that time I was still a director) were grateful for the additional funds, but we discovered that using those funds put the SBDC in some peril as the centers would add personnel and programs. This spurt of increasing activity when budgeted on an annualized basis meant that funding for the following 12 month period had to be substantially increased if services were not to be reduced later.

These financial problems were not all the making of OMB or SBA. The Congress must share a portion of the blame for the erratic funding because SBA's appropriation was usually not enacted by the beginning of the new fiscal year. A continuing resolution thus had to be passed which had the effect of freezing our funding at the prior year's level.

This leads to my first major recommendation. A way should be found to fund SBDCs so that each state knows the amount of federal funds that will be made available to it at least 12 months in advance of a new contract period. In addition, the contract period should be for a minimum of two years. Being subject to the vagaries of the federal budgetary process on a short term basis is simply too disruptive to the state programs. The real injured party then becomes the small business sector as SBDC administrators have to devote inordinate amounts of time and resources to fiscal matters at the expense of substantive program administration.

Adoption of these two recommendations would help cure an administrative problem as well. SBA, to its credit, has instituted a funding application procedure that has specific timetables and defined responsibilities for the SBDC, district, regional and central SBA officials. This new procedure should go a long way in helping to eliminate the administrative log-jams that often arose when processing our funding applications.

But, an enormous amount of paperwork still must be processed. The agency needs good administrative and financial control over the program, but as a director, I spent an excessive amount of time responding to requests for annual budgetary and contract information. Base line funding for two or three year periods would significantly reduce this burden.

Another major problem that existed for some time was a lack of what we, the directors, perceived as a commitment by the agency to the program. This ambivilance caused communications to break down and misunderstandings to arise. Many centers and their directors were, to say the least, discouraged and some states came very close to withdrawing from the program.

During my time at Georgia, the SBDCs also experienced some growing pains in terms of internal development within our states. Some SBDCs have found the commitment by the university and/or state officials to be wanting. This caused difficulty for some centers to obtain adequate resources to fulfill their commitment to the small business community.

Most of those situations have fortunately now been corrected and much stronger programs have emerged as a result.

To assure that statewide SBDCs continue to adhere to the statutory guidelines of the Small Business Development Center Act of 1980, the Association has now named a Standards Committee which has developed over the last 18 months criteria by which an SBDC may be qualitatively judged. It is the intention that this peer review process will serve as a mechanism to constantly upgrade and improve each SBDC operation. Coupled with the collection of the CQQI performance data, small businesses should thus be assured of continuing to receive relevant management and technical assistance.

Another helpful tool would be for SBA to become more aggresive in fulfilling its statutory commitment of "maintaining a clearinghouse to provide for the dissemination and exchange of information between small business development centers..." The Association has a major role to play in disseminating such information, but I believe the agency should also fulfill its statutory obligation. Individual centers continue to develop imaginative, creative services, but these new initiatives are not adequately being made known to the rest of the SBDC community. Reinventing the wheel can be avoided if SBA informs each SBDC as to what the other SBDC is doing.

That concludes my overview of the national SBDC program as I witnessed it evolve. Now I would like to focus on the SBDC of Georgia, specifically its organization, operation. and economic impact.

In 1977, The University of Georgia was selected to manage one of the first eight Small Business Development Centers. I was named as the center's first director. The University of Georgia was given responsibility for the program and provided $200,000 to be used with $40,000 of federal funds to start operations of the SBDC in Georgia.

The original Georgia plan calling for 12 district offices, each in cooperation with one or more of the state's institutions of higher education, has been completed. The 12 offices have been established and have placed management assistance services within a few miles of every business in the state. Reception by small business has been so good that keeping pace with the demand has been difficult.

As data presented in Table 1 of this testimony shows, in-depth counseling cases (more than 12 hours) increased 160 percent over the past two years. Cases of 6 to 12 hours increased 231 percent, and short-term requests increased 60 percent. The demand curve has not begun to flatten. There has been an 88 percent increase in in-depth counseling for the first five months of calendar year 1983 over the first five months of year 1982.

Data presented in Table 2 reveal similar growth patterns in participation in continuing education courses. The number of courses increased 91 percent over the past two years from 294 to 562, and participation increased from 9.8 thousand to 18 thousand, an increase of 83 percent. Experience for the first two quarters of 1983-84 reflects similar increases.

Table 1

Increases in Counseling
Georgia SBDC
1980-81 through 1982-83

	1980-81	1981-82		1982-83		
	# of Cases	# of Cases	% Change	# of Cases	% Change Prior Yr.	% Change Two Yrs.
In-depth cases (over 12 hrs.)	300	550	+83%	780	+42%	+160%
Less than in-depth (6-12 hrs.)	800	1,339	+67%	2,650	+98%	+231%
Requests for information (1-6 hrs.)	2,000	2,111	+ 6%	3,200	+52%	+ 60%
	3,100	4,000	+29%	6,630	+67%	+114%

Table 2

Increases in Continuing Education Courses
Georgia SBDC
1980-81 through 1982-83

	1981-81	1981-82		1982-83		
	Number	Number	% Change	Number	% Change Prior Year	% Change Two Years
Courses	294	351	+19%	562	+60%	+90%
Participants	9,857	13,152	+33%	18,029	+37%	+83%

When The University of Georgia proposed an SBDC, a evaluation process was begun. For counseling, the plan included a subjective evaluation by the client upon completion of the case and a more objective evaluation to be performed after the case had been closed for one year. The objective procedure was designed to identify changes in sales, profit, and employment for the year following counseling. A third phase which will include a study of firms counseled five years earlier will be completed in 1985.

In the fall of 1982, a method was devised at The University of Georgia that could be used by all SBDCs to determine the impact of their counseling on sales, profit, and employment. The methodology was applied to the 700 Georgia businesses counseled in 1980-81. Data were collected for sales, profit and employment after at least 12 months of operation subsequent to counseling.

The study for Georgia (see Exhibit A) found that 75 percent of businesses increased their sales volumes; 67 percent increased profits; and 64 percent added employees or experienced no change in employment. State and local revenues were returned at a 14.9 to 1 ratio without taking into account the multiplier effect, and this return resulted from the counseling activity only which represented no more than 30 percent of the total program activity. Federal revenues were generated at the rate of $7.33 for each federal dollar spent.

The same impact study was conducted by nine other mature SBDCs (see Exhibit B). Data reflected greater impacts

in these nine states than in Georgia alone. Return of federal dollars on all expenditures from only 30 percent of the SBDCs activities was $9.40 per dollar expended; for states, the return was $12.50 per dollar spent.

The Georgia SBDC includes the State Office of Minority Business Development. This office serves as an advocate within the SBDC. As well as generating special programs, 24 percent of counseling cases in 1982-83 were for minority businesses. Only seven percent of the businesses in Georgia are minority owned.

Thirty (30) percent of the counseling cases were for women owned businesses. This percentage approximates the percentage of women owned businesses in the state. Thirty-three (33) percent of the participants in the 562 continuing education courses were women.

Seventy-two (72) continuing education courses designed specifically for minorities attracted 2,664 participants. An encouraging trend is the attendance of increasing numbers of minorities for the small business courses offered to the general public.

Another significant activity of the OMBD is its work with two cities, Augusta and Macon, to put minority persons into business on a sound basis. Each community matches $50,000 of state funds annually through a challenge grant program. Individuals are selected, training programs implemented, feasibility studies completed, and assistance in seeking adequate financing given. After start-up, SBDC counselors will work with the business owners. It is anticipated

that the program, if successful, will be expanded to include each of Georgia's SMSAs.

Other programs conducted by the SBDC's Office of Minority Business Development include the Black Youth and Entrepreneurial Program, a program for high school students that has won national recognition through a Freedoms Foundation Award, the black youth internship program which places college students in a six week internship program in black businesses, and a lecture series cosponsored with the Martin Luther King, Jr. Center for Non-violent Social Change, which has as its theme, "The Free Enterprise System: An Agent or Non-Violent Social Change." Our Committee Chairman, the Honorable Parren J. Mitchell, initiated the series with a presentation entitled, "Jobs and Full Employment."

The Georgia SBDC also has an International Trade Development Center. It identifies small businesses that are not exporting but that have the potential and work with them to move into exporting. One hundred twenty-six (126) businesses were counseled and 580 business persons attended 17 seminars on international trade topics in 1982-83.

The model works. Of the 36 ITDC clients with measurable financial data, 86 percent reported that export sales had increased over the two year period since beginning ITDC consulting in 1981. Export sales for the group grew from 11.5 million dollars before consultation to 21 million in 1983, two years later, for an increase of over 9.5 million or 84 percent. Of the 31 firms who reported increasing sales

over the two year period, 22 of the firms had not exported prior to consultation with the ITDC. Two years later, these 22 firms reported export sales of $5.6 million.

If one can assume that the remaining clients of the ITDC had similar export experiences, export sales for clients served would have been over $56 million in 1981 and over $103 million in 1983.

As you can tell, Mr. Chairman, I am very proud of what the SBDCs have been able to achieve at the national level and in the accomplishments to date in Georgia. With continued support of the federal government, the potential of this program is unlimited.

Before closing, however, I want to urge you to consider two other statutory changes besides the recommendations dealing with the budgetary planning process. First, I request that the provision calling for an October 1, 1984 sunset, Section 204 of Title II, be repealed. I believe the program has operated with distinction to date and after hearing the brief impact analysis, I hope you will join with me in concluding that there has never been a more remarkable or responsive outreach program for small business. This Committee in innumerable hearings over the last several years has documented that the number one problem of small business is the need for more management and technical expertise. I therefore hope you will elect to make the SBDC program permanent.

The other recommendation is that every state should be required to file a plan for statewide SBDC services when

submitting an application to SBA to participate in the program. Section 21 (b) (1) of the Small Business Act makes such a plan a requirement only through fiscal year 1983, meaning that beginning this fall multiple sponsors could participate within a state without there being any one coordinating entity.

In terms of program direction, I encourage SBA to continue to experiment with various SBDC formats and sponsors. I know associations, junior colleges, engineering schools within universities, and other groups are considering being the coordinating body in states that will soon apply to come into the SBDC program. As long as prospective sponsors have the adequate depth and breadth of resources mentioned earlier, I know their participation would be welcomed. I believe universities have proven their value in terms of sponsorship, but I would never suggest they have all the answers. Having said that, I continue to believe that universities are the best delivery mechanism for providing management assistance to small business.

Finally, those who are involved at the federal level should be ever mindful that this is a partnership between the states and the federal government. We all should be vigilant to assure that each state SBDC addresses the needs of small business within its boundaries. Perceived priorities and issues at the national level may be of little or no concern within a given state, or vice versa. A balance must constantly be maintained so that both the state and federal small business interests are maintained.

Thank you again for this opportunity to appear before you today.

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Georgia
Impact Study
Performance in 1981-82 of the 700 Clients Provided In-Depth Counseling in 1980-81

Table 1

Comparison of % Changes in Sales, Employment and Profits with Average % Change of All Georgia Business

	Average Percent Change, SBDC Clients	Average Percent Change, All Georgia Businesses
Sales	+25.2%	+4.0%
Employment	+ 8.7%	-1.1%
Profits	+25.1%	+7.1%

Table 2

Dollar Average Incremental and Aggregate Changes in Sales, Employment, and Profits

	Average Increases Per Business	Total Increases for Client Firms
Sales	+268,804	+188,162,590
Employment	+ 3.56	+ 2,492
Profits	+ 9,497	+ 6,648,000

Table 3

Additional Revenues Generated: State and Federal

	Estimated Tax Revenues Generated Only by Counseling 1981-82	Funds Expended by SBDC for All Programs [1] 1980-81	Ratio: Benefits to Cost
State	6,600,000	443,000 [2]	14.9 to 1
Federal	3,300,000	450,000	7.33 to 1
Totals	9,900,000	893,000	11.1 to 1

[1] Funds were spent, not only for counseling, but for 228 continuing education courses, reaching 6,421 participants, numerous research projects, a minority program and an export increase program.

[2] Funds supplied by State (560,000) less charge for overhead returned to State from Federal funds (117,000).

Exhibit B

IMPACT STUDY
PERFORMANCE IN 1981-82 OF THE
CLIENTS PROVIDED IN-DEPTH
COUNSELING IN 1980-81 (9 STATES)

Table 1

Comparison of Changes in Sales, Employment and Profits with Average Percent Change of All Business in States Studied (Nine States)[1]

	Average Percent Net Change--[2] SBDC Clients Over All Business	$ Net Increase SBDC Clients Over All Business
Sales	+ 25%	$709,571,000
Employment	+ 23%	12,757 (new jobs)
Profits	+ 83%	$107,782,000

[1]Alabama, Florida, Georgia, Massachusetts, Nebraska, Pennsylvania, South Carolina, Utah, Washington

[2]8,859 clients were counseled.

Table 2

Additional Revenues Generated: State and Federal[1]

	Estimated Tax Revenues Generated by Counseling, 1981-82	Funds Expended by by SBDC for All Programs[2], 1980-81	Ratio: Revenues Generated to Funds Expended
State	$31,430,000	$2,507,000	12.5 to 1
Federal	$27,837,000	$2,951,000	9.4 to 1
TOTALS	$59,267,000	$5,458,000	10.9 to 1

[1]Six states included Alabama, Florida, Georgia, South Carolina, Washington, Wisconsin.

[2]Funds were spent not only for counseling, but for hundreds of continuing education programs that reached tens of thousands of small businesses. Many special activities, such as international trade programs, minority programs, procurement programs and research, were supported by these funds.

Exhibit C

International Trade Impact Data

	TOTAL EXPORT SALES FOR 36 ITDC CLIENTS
1981	11,476,250
1982	14,525,020
1983	21,070,240

	TOTAL EXPORT SALES INCREASE FOR 36 ITDC CLIENTS	
	$ Increase	% Increase
1981-1982	2,775,770	27
1982-1983	6,545,220	47
1981-1983	9,593,990	84

TESTIMONY OF JOHN KOMIVES, THE LAKE SHORE GROUP

Mr. NEAL SMITH. Mr. Komives.

Mr. KOMIVES. Mr. Chairman, committee members, my name is John Komives. I'm the founder and president of a company called Shore Lake Group in Milwaukee, WI. I left there yesterday thinking I would escape the snow and the storm only to find that it's here today.

Our company works on a private for-profit basis as consultants to smaller growth oriented companies. I have no previous or current connection with any Small Business Development Center other than starting a year ago I was asked to serve on the steering committee of the Wisconsin SBDC as one of the independent business people that's on that committee. There are six of us.

I'm glad to be here again. I testified before this committee and to the Senate Small Business Committee on the establishment of the SBDC Program back in 1972, again in 1976 when the initiating legislation was again brought forth, and again in 1980 when there were some serious problems on funding consulting work in competition to private consultants. So it looks like every 4 years I somehow get invited to come back and testify.

I must say to you that after all these years I am delighted at the result that has come about from the SBDC effort. As we stated back in 1972 and 1976, the original model was the Agricultural Extension Program and how well that has worked in the United States to bring technology and management assistance throughout the United States. It seems to me that the SBDC Program follow-

ing that model is doing very well and hopefully, if you'll look at some of the recent statistics of the emergence of independent business around America, it is obviously having some positive impact.

The fascinating part about the agricultural extension model is that peculiar marriage between the Federal Government, State government, and the university systems throughout the United States, as well as the county courthouse involvement with that whole matter.

The SBDC Program is using that system again in a partnership arrangement. Now, the partnership that we talk about between the Small Business Development Center and the State government and the universities is a very delicate affair.

As every married adult knows or soon learns, that people bring to the partnership a very delicate set of continuing relationships. I must say to you that I'm a bit disturbed by the reading of the testimony to be given this morning by the Small Business Administration to this committee because of the tone of that testimony.

The tone suggests that the SBDC Program is driven and managed by the SBA, and that somehow or other the management of the SBDC Program is totally in the hands of the SBA. Maybe I'm reading more into the tone than is actually there, but I'm a bit disturbed about it because I look at the SBDC Program again, as a partnership between the Federal Government, State government and the university system. I think we need to be very gentle and very careful about alterations and adjustments to that relationship lest we unbalance that relationship to the detriment of everyone.

This relationship is critical because until the SBDC Program was developed and is in the midst of developing today, the small business sector, that's any company with less than 1,000 employees, had no home in the university system. The one thing that the SBDC has done is that it has made small business attractive for study, for counseling, for management assistance by the major university systems throughout the country.

Until that time, the universities disdained any involvement with small business. Now we have raised the stature of small business into the university community using the mechanism of the SBDC and I would hope that we would not ruin what we have now created. I think this new statute is a very plus factor in our favor.

One of the issues that is being raised in these hearings is decentralization and the role of the district director and there are some great problems when you do that and I will address the problem this way.

I personally am in favor of decentralization. I think that the tone in this country of moving things back to the State level is an excellent concept for self-management, but you run into a problem here in terms of the SBA's operation at the State level.

The problem lies in that the State district director is not elected by any official in the State. That person is appointed and operates as a part of the power structure coming out of Washington, and the career path of the State district director is from there to the region

and hopefully, if he or she is any good at all back to the home office here in Washington.

The concept of decentralization is to move the decisionmaking powers back to a responsive citizen, a person who is elected at the State level.

Now if you want to move the power of the SBDC management program back to the State level, you ought to move it back to the Governor of the State or the State legislature, but not to a bureaucrat whose career path is not based upon what is in the best interests of that particular State.

My final point is that I keep hearing is that the SBDC competes with private consultants like myself. I must tell you in all the years that the SBDC has been operative in the State of Wisconsin, I have never found it to compete with me and I'm in the same general marketplace as the SBDC.

What happens, and I'm very thankful to the SBDC in Wisconsin, is that it creates clients for me. It takes people who are unskilled in using consultants. It takes people who are afraid of consultant fees. It takes people and puts them into a mode of dealing successfully with a consultant and when their business finally reaches the point where it can afford a private consultant, the independent business owner/manager is the first one to leave the SBDC and come to my door asking to pay me for my consulting help. So I look to the SBDC with thanks for creating clients for me, paying clients, people who know how to use a consultant and use them effectively.

I don't view the SBDC as in any way a competition but as a help, creating the client base that I now have. I can point to three good clients I now have in my coterie who came to me as a result of the SBDC effort.

In conclusion, I just ask you to renew the SBDC funding and to renew its legislation and to look very carefully at some of the changes that are being proposed in the management of the SBDC so that we don't mess up what seems to be a successful track program.

With that, I thank you for the opportunity again to present my views and will be responsive to any questions you have.

Mr. NEAL SMITH. Thank you very much.

I want to say that the testimony of all three has been very valuable. Mr. Cowart brought us some very valuable statistics that I have not been exposed to before—the study where we get $18.73 return for each Federal dollar that we put into the program.

I am a little bit puzzled, though, by a couple of things. Mr. Bramblett, whose counsel we used almost daily 5, 6, or 7 years ago in working on this program, made a statement about peer review.

Don't we get peer review when SBDC's have to put up half or a minimum of 50 percent of the money—in many cases it's a lot more than 50 percent. They have to go to the legislature to the business community. By the time they get through with getting their matching funds, haven't we had a sort of a peer review?

Mr. BRAMBLETT. We certainly have had a peer review. During my tenure, this program was evaluated to the mth degree. The GAO couldn't get out until somebody from the SBA got in. They were waiting in line at the front door.

I'm suggesting to you that, yes, sir, you do have a peer review, a peer process, that constituencies serve the ones that are evaluating the program.

If there is anything more than that needed, then I would suggest to you that there be a peer involvement in say a national programmatic review of institutions and organizations.

You and I know that there are going to be certain problems come along from time to time. That's the way it is in any organization. At that point in time, the peer process, is the way to handle the problem and to contain the creativity.

These institutions are competing, in a national arena of reputation and that's all I'm suggesting to you on that matter.

Mr. NEAL SMITH. Two or three of you have alluded to the authority of the State director and direction from SBA. How much direction does a district director of SBA try to give to this program?

At the time and SBDC makes application and it's approved, haven't they really got a program that almost administers itself?

Mr. BRAMBLETT. In our State there was very limited SBA involvement except in the annual planning process. There was a very limited involvement in the program.

I guess my comment there is I suggest that that be continued. You know, I don't think you would want to increase the level of involvement in that process. There's enough there. If you have an ongoing information retrieval system, you need no more.

Mr. NEAL SMITH. You're not really saying there is an attempt now to——

Mr. BRAMBLETT. Over the 5 years that I worked with the program, there was a tendency to interfere. You have different individuals with different personalities around the United States. Everybody has an opinion and everybody has a career track, and a career path.

You do not want to program to get in the position that it's at the mercy of someone's career track or personality or their opinion.

Mr. NEAL SMITH. I agree with that as I mentioned to you, and I know you're aware of this, while this program was being tried out there was a great deal of jealousy by the management assistance people in SBA and they didn't want to implement the program at all, they didn't want the program, and we helped to get them over that by reducing very substantially the amount of dollars going to that part of SBA. They don't have as many of those people around to be jealous any more.

Mr. BRAMBLETT. Right. I doubt very seriously that jealousy exists today. I think you've probably corrected that.

Mr. NEAL SMITH. I detected in the hearings we held this year that we didn't have that kind of jealousy any more.

Mr. BRAMBLETT. I would say that's true.

Mr. NEAL SMITH. Mr. McDade.

Mr. MCDADE. Thank you, Mr. Chairman, and let me thank all of you, too, for coming this morning and giving this excellent testimony. I think it makes us all pleased to see that the program that we started as a pilot program has worked so well, and as I listened to your testimony that is really what I gather to be the bottom line, that because of you people this program has worked impressively well.

You can each comment on it if you like, or whatever way you would like to proceed, because there is some, as you know, conversation that the administration wants to see the program go back to central office and when we originally structured the program we hoped it would reflect what we believe it does now, which is a local decisionmaking process in which you, as the chairman has indicated, actually receive the plans that have been formulated at the local level and then proceed.

Now given that history of success and given that history of flexibility, why shouldn't we keep the statute as it is without any change whatsoever, keep the administration as it is and keep the program running as it is?

Mr. BRAMBLETT. That would be my recommendation, too.

Mr. MCDADE. You would recommend that it be done?

Mr. BRAMBLETT. That's right.

Mr. MCDADE. What about the gentleman from Florida? Would you tell us your experience with that, please?

Mr. COWART. Well, my experience with that, sir, when I left the program this was not a problem. I've always operated under the original concept and it worked fine.

When the system first started, the States were pretty much left alone, appropriately left alone, to develop our programs to determine which was going to be the right way to go for the Nation. It seems like we all came out with essentially similar programs and the input in Florida from the district director was precisely as it should have been. We coordinated with each other. I don't recall dictatorial tendencies at all, and so for us it worked fine.

Mr. MCDADE. OK. Fine.

Mr. KOMIVES. The Small Business Administration manages its funds and therefore it has its own internal management system for overviewing the program and for agreeing to a contract or negotiating further on a contract.

The concern that I have is that what I hear on the street is that internally the management is changing its direction. It is changing its view as to how that district director is to interface with the SBDC program in a particular State and you probably cannot do much about it legislatively because you are then interfering with the management of the system.

The point I'm driving at, though, is that the SBA does seem to be changing the way it wishes to manage the SBDC program and I would think that an expression from Congress that the system seems to be working very well and ought to be maintained without dramatically changing that internal management system, I think, would have a very strong impact on keeping the growth of the system intact.

Mr. MCDADE. OK, so if we were to try to sum up what you're saying, you would like to have an expression that the committee would like to see the program continued as it is, but you would not favor a statutory change that would mandate something in the program.

Mr. KOMIVES. Not at this moment, that's correct.

Mr. MCDADE. Let me ask you this question. I would like to get the benefit of your experience about this.

The administration is talking, too, about the necessity for permitting, not requiring, but permitting, for profit consultative type groups—as you know currently they are not permitted—to be a prime sponsor of one of these programs.

How do you feel about that? What do you think the impacts would be if legislation were to permit for profits to intervene?

One of the examples given, and let me just try to focus it if I can, is that if you wanted to go, let's say, to some very high tech operations, like a computer seminar or something like that, and we've had a couple of references to the uses of computers here this morning, that it might be useful to get the people in the computer industry itself to be involved and almost all of them are for profits and therefore if you exclude the for profit you might not have an opportunity you might want to utilize.

What is your feeling about that, please?

Mr. COWART. I would like to comment that the university as a base for the SBDC operation is an ideal base in that it spans such a range of disciplines to include state of the art computer instructions.

I don't speak against private firms assisting in the program. I don't speak against that at all. I would encourage that at the behest of the SBDC, should they see that it is a good thing to do, to bring in a computer firm in a consultative capacity for whatever reason.

Mr. MCDADE. And you have the capacity to do that now, do you not? I think we heard in testimony that you do that quite frequently.

Mr. COWART. Yes, indeed. Yes, sir, that's one of our strongest programs. I think on almost all campuses today if you don't have a strong computer science program you're not serving the public as you should.

Mr. MCDADE. It was impressive, by the way, for the committee to see the use of your bid information system and the way you get it out to your local community. That was a very good impressive statistical example of how you can really benefit through this program to make your people players in a game they might not otherwise be in.

Mr. COWART. It works well. The Info-Bid program which you're addressing, I suppose is now in several communities. I believe Wisconsin is one of the large ones and some other states as well.

Again, back to private firms, to administer this program the university is I believe the proper base for several reasons but mainly because we are everywhere. The network is national and it is not going to, I think, favor one private concern over another so much. It should be able, however, to call in private firms for expert assistance.

Mr. MCDADE. Thank you. Any other comments?

Mr. BRAMBLETT. I've got one comment that from the private sector, and that's where I am now, I think the existing structure, is using private sector organizations within the framework.

I have a problem with housing a federally funded program administered by or led by a private sector for-profit firm because the goal of any for-profit firm is in fact to make money and there can arise, and that's the case in my firm, that quite often the public's

best interest and immediate objective is served by for-profit firms, but there is potential that the common good may not be served if a for-profit firm provides the leadership. You still have and in fact you do have legislation already in place that takes care of an existing framework of the participation.

Now there's another issue here at stake. I strongly encourage SBA and the universities and the Congress and everyone in the private sector to participate in the innovative projects, but at the same time I would discourage the deluding of the Federal and State programs to the extent that we all come to Washington and we all want a piece of the pie and I've got a better idea than somebody else.

You've got a framework that ascertains at this point in time who has the best ideas and who has the potential for having programs, so I don't think you want to create by no means, disgress and create a situation in which the SBA can ascertain who has the best idea of the month and go out and start these little programs all over the Nation. That's an underlying issue I think that you've got to look below the surface.

Allan, I would have to disagree with you on the universities' computer expertise. There are certain universities that have very elaborate computer science programs but the hardware R&D, that's in the private sector and these partnerships can be formed in which you tap those and they are being hit and that is being done.

There are going to be times when the private sector leads in a particular area in R&D and there are going to be times, most of the time, the university environment is going to lead, but when that happens it's incumbent upon the SBDC to go out and seek out and tap the private sector for support. There are many, many ways that the private sector can benefit in the short-run and the long-run without having to be involved in the leadership or the running of such a program because that's not what they're all about. They're about making money, not running a public program.

Mr. KOMIVES. Mr. Chairman, the issue that is being raised here, as I understand it, has to do with the fact that the SBDC is viewed as a management assistance program and the problem is at what point you reach out and involve technology into the program.

Mr. MCDADE. Well, it's even more basic than that I think because the basic statute now says that a for profit may not be involved at that juncture as a matter of policy and the question is whether we should continue that or not.

Mr. KOMIVES. Right, and I guess I would come down to suggesting that we ought to experiment with it, that if the local SBDC finds that it's in their own best interest going through the normal mechanisms of justifying that this contract with this for-profit organization makes sense, then it ought to be allowed to experiment with it. Then let's go back and look at it a year or two or three down the road and just see what happens in terms of its impact.

Generally speaking, universities are not, in many areas at the leading edge of emerging technologies that impact on new businesses and small businesses. We ought to have some way or mechanism of being able to pull that in and invoking it even if it is a for-profit, without dismantling the whole present system. I think experimentation ought to be allowed.

Mr. McDade. OK. We'll have some additional questions that we'll submit to you for the record, but I certainly do want to thank you for your testimony. It has been very, very helpful to the committee.

Unfortunately, if you will excuse me, I have to leave. I have another committee in session since 9:30, but again let me thank you and the other panelists for being here for the benefit of your wisdom. Thank you very much.

Mr. Neal Smith. Mr. Olin, did you have any questions?

Mr. Olin. Thank you, Mr. Chairman. I have a couple. I was afraid the panel was about to vanish here.

I would like to compliment you three gentlemen on the extremely beneficial testimony and I think you have great knowledge of the subject and good objectivity and I had reached the same conclusion that Mr. McDade reached, that you are basically solidly in favor of this program and would like to see it expanded and continued and not altered too much. I'm very new on the scene here and I don't really understand exactly what the administrative setup is. I wonder if you could describe that.

How is this program run in a State? What is your tie with the SBA, and what are the types of things that you feel should not be centralized, that you seem to be worried about? Could you be more specific about that?

I'm having a little trouble. You're being very general the way you talk about this. Could you be more specific? How do you run the thing in the State first and then what are you worried about?

Mr. Bramblett. In the State of Georgia we have a central center, a lead institution and that happens to be the University of Georgia. It could be a couple of other universities, probably, but that's the land grant institution and has most of the funds for outreach and service in the State of Georgia.

The SBDC is managed in concert with the State Board of Regents which sits over the entire higher education program of the State, and in concert with the State legislature and the Governor's office, and it advised and so forth and so on by those entities including an advisory council of small businesses.

From that, from that central operation, come a proliferation of service centers, delivery points, which report back to that central operation, and in some cases those remote locations have layers of management and supervision.

Mr. Olin. When you were director, who did you work for?

Mr. Bramblett. Well, I had two or three bosses but at that point in time——

Mr. Olin. Who paid you?

Mr. Bramblett. University of Georgia paid my salary.

Mr. Olin. University of Georgia was running the program. You were their agent in helping to coordinate it.

Mr. Bramblett. That is correct to the extent that you must understand that the Governor and the State legislature and others were very heavily involved in what that program was to look like and what its mission in life was and what it was to do, but the daily operations, you're correct, the University of Georgia was running it.

Mr. Olin. Where was the nearest SBA man?

Mr. BRAMBLETT. At one point in the program we had an SBA employee in the office on location but for all practical purposes geographically he was 65 miles away in Atlanta.

Mr. OLIN. Did they call him a district man, a regional man.

Mr. BRAMBLETT. What did we call these people: Liaisons? They were former management and generally speaking MA officers.

Mr. OLIN. Did you have all the decisionmaking authority with regard to your service centers and things of that nature, how you were going to set it up in the State, what programs you were going to run?

Mr. BRAMBLETT. Yes, we did. That was enacted in the legislation in our State.

Mr. OLIN. Did the SBA have any oversight authority, decision authority?

Mr. BRAMBLETT. They were involved heavily in the annual planning process and certainly it was more of a partnership type—they were in concert assisting us in the delivery of services.

I think the issue that's here today if there could be some language in the legislation that would say that before you get us in trouble down there in Georgia let's check with central SBA. That's all I'm saying to you.

Mr. OLIN. I'm not sure I'm understanding that.

Mr. BRAMBLETT. I'm sorry I'm not able to——

Mr. OLIN. I have a little trouble really. You want the SBA involved. They're your channel of part of your funding.

Mr. BRAMBLETT. Right.

Mr. OLIN. And they coordinate among the States to help you learn what other people are doing.

Mr. BRAMBLETT. That's right and I don't think that there's any problems at all with that. No problem with that.

Mr. OLIN. Now what is it you have a problem with?

Mr. BRAMBLETT. I don't have a problem. I'm saying to you that there has been history with the program where there have been personality conflicts and so forth and so on.

Mr. OLIN. We're always going to have personality problems.

Mr. BRAMBLETT. Certainly, you can to a certain extent legislate safeguards. I can remember when Governor Busbee was in office in the State of Georgia that agency that had OSHA, he kicked them out of the State because he and the regional director couldn't—he didn't want any of the Federal money. He kicked them out.

I think at least the central office to a certain extent should be involved that there should be mechanisms or vehicles built into the situation in which a situation like that could not occur before it was called to the attention of some high official in Washington who would be sitting there with the policy and directions and so on.

Mr. OLIN. How about the decision regarding establishing a certain service center some place in the State?

Mr. BRAMBLETT. That's a local decision. That must be a local decision.

Mr. OLIN. You're not suggesting that that ought to go around to——

Mr. BRAMBLETT. No, sir.

Mr. OLIN. Do any of you others have a comment on this area?

Mr. BRAMBLETT. That's an SBDC decision, by the way, where the funds are to be expended; that is a local decision.

Mr. OLIN. Thank you very much.

Mr. COWART. Mr. Olin, I think it would be inappropriate for an SBDC to establish a new service center without coordinating it fully with the district office.

In Florida we have two district offices, and therefore, coordination with both of these offices is necessary. I wouldn't want to do that if it came to a "yes-I-am no-you're-not" thing. I would insist on prevailing. It's half my money. It's half SBA's money, too.

Mr. OLIN. You're saying it's a joint decision, shouldn't be totally in one party's hands or the other, but that in the case of a little difference of opinion the SBDC should rule. Is that right?

Mr. COWART. I think it should be a coordinated decision, if I may say so, as opposed to a joint decision. It's a coordinated decision and I've never come up against a decision where we were at loggerheads and could not move off dead center. Coordinated I think is the appropriate term there. In Florida it's always worked well.

Mr. OLIN. You would not favor legislation that would clearly define the authority for decisionmaking in one place or the other? You'd like to keep the legislation so that it encourages mutual activity.

Mr. COWART. Yes, sir, I think so. Inasmuch as a dollar is coming from the Federal Government and a dollar is coming from the State, we must operate as a partnership in that sense.

I think that the authority is a joint authority, all right. However, the store has to be run, as it were, by the State university system, by the SBDC. In the final analysis we have to keep the store and I guess we know our communities as well as anyone.

Mr. OLIN. Do you have any comment on that, Mr. Komives?

Mr. KOMIVES. The only concern I have has to do with the way the mechanism works in terms of veto power.

The State district director has certain rights to veto the proposal for the forthcoming year unless you somehow negotiate with him. That's a very sensitive area in terms of how you arrive at a new contractual relationship each year. You have to deal with a whole mess of parties. Then you have or you could have, and we've experienced it on some rare occasions, not currently, an adamacy on the part of the State district director to see evolving programs and new thrusts and new directions that the local SPODC guys want to take that is not within his SBA district directors program concept or what he's been directed to do from headquarters.

It's a delicate set of relationships that need to be reworked continuously and I'm concerned that in their testimony SBA, is changing their attitude about how that will be managed from headquarters. I'm just concerned. I haven't seen it in practical results, but I am concerned.

Mr. OLIN. I'd like to ask one more question of Mr. Bramblett. In your written testimony you've commented on the subject of the perceived commitment of the agency, the SBA, to this program.

Did you want to expand on that anymore?

Mr. BRAMBLETT. No, sir. I think that's historical. That's past history.

Mr. OLIN. Is it getting better?

Mr. BRAMBLETT. I think it's getting much better.

Mr. OLIN. Fine. Thank you very much.

Thank you, Mr. Chairman.

Mr. NEAL SMITH. Mr. Chris Smith?

Mr. CHRISTOPHER SMITH. I think Mr. Bilirakis should go next.

Mr. BILIRAKIS. Thank you, Mr. Chairman.

I know we all were interested in the ratio that the chairman alluded to or that Mr. Cowart alluded to. Assuming that there are other ratios in other SBDC programs, did these exist, Mr. Cowart?

Mr. COWART. My assumption is that most State programs would have such a ratio.

Mr. BILIRAKIS. I wonder, Mr. Chairman, if we could have that information submitted for the record. It's something I think would be of interest to all of us and certainly of interest to the American taxpayer because it's an indication of good use of their tax dollars and I would think that we should have that information and I would ask that that be submitted to the record.

I also would go on to your reference, Mr. Cowart, to the Info-Bid project in Florida. We've had a number of hearings here with the problems of the SBA's PASS system, with the similar type systems, and I wonder if you could provide us with the strengths and some of the details of your Info-Bid system so that we could compare that with the SBA's. There's a possibility we may pick up some ideas that might be applicable to the PASS system.

Mr. COWART. Yes, sir. As I have always perceived it, the PASS system is a system that is more generic than the Info-Bid system.

The Info-Bid system extends the PASS system and really puts it into absolute operation. It's the bottom line of the PASS system, as it were. That's one sense of the explanation.

Info-Bid is guided by SIC numbers, standard industrial code numbers, for manufacturers. For example, a roofer in Lakeland needs to be aware that the courthouse in one of the counties there requires a new roof and it has to be bid. The Info-Bid system gets this notice and it matches the SIC code of the small contractor with the SIC code of the contract to be bid and it mails out to all participating roofing contractors notices of that bid so they may have a bid on it. Recipients will also get the name of the person to contact for additional information, the cost of reroofing the courthouse the last time it occurred and other details.

Mr. BILIRAKIS. To keep from having to spend any more time on that, I would appreciate it if you would furnish the committee with further details on the Info-Bid system.

Now do you have these ratios for these other SBDC programs? That is not available to you?

Mr. COWART. No, sir. Those are State ratios. My assumption is that the other States, if they don't have them, they could get them.

Mr. BILIRAKIS. Could get that from the SBA, I suppose.

Mr. Cowart, and I guess I would ask all three of you gentlemen, and I believe Mr. Daub is going to go into this in further detail, but, sir, you referred to the fuel crisis of 1974 and you gave us some very imaginative ways in which you were able to overcome that, I just wonder if section 4 of this bill, which I understand the administration is not necessarily a proponent of, I think Mr. McDade may have misspoken there when he talked about the ad-

ministration, but if section 4 were in effect back at that time would you have been able to put into effect all of these imaginative programs, television and all of these other things that you did in order to be able to overcome the crisis that you ran into?

Mr. COWART. Sir, I regret that I only received the legislation this morning and I have not had a chance to read it.

However, if section 4 restricts the ability for the typical university system to continue its R&D activities and to be innovative in serving its constituency, I would be very much opposed to anything that would restrict that.

One of the delights in getting this program started, and it reflects to the wisdom of those architects of the program, is that we were allowed to do what the community needed. We were not restricted by anybody, only money, and so we did what we needed to do and that allowed us to be innovative and to respond to our community. Any restriction to that would be inappropriate.

Any restriction would say that somebody knows more about your community than you do, and I don't believe that to be true.

Mr. BILIRAKIS. What about the section 5 mandate that requires that SBDC's be located in commercial-type facilities, because I know both you and Mr. Komives, actually all three of you gentlemen have talked about a partnership between various levels of government and the university system.

How would that be affected by the commercial-type facilities mandate in section 5?

Mr. COWART. Well, I must give my philosophy to you, sir, and that is that it was designated originally as a university-based program for a very good reason, because of the breadth of services we are able to provide and the education that we are able to offer.

To remove the base from a university base makes no sense to me. I can't conceive of that.

Mr. BILIRAKIS. Do you know of any or many instances where people needed the services available but the university was not as available to them as possibly some sort of a storefront commercial-type facility.

Mr. COWART. Ah, now I think I see what you're saying, sir. Let me restate.

In Florida each SBDC may have many storefront facilities all over town. We may have several what we call service centers. In the black community and in downtown chambers of commerce, all over. That's the way we greet the public.

When you said "base," I was thinking of the principal entity.

Mr. BILIRAKIS. Well, the way the legislation reads it could mean that, it seems to me.

Mr. BRAMBLETT. May I comment on that? I think that's generally speaking the way the program is operating now. I know what the language would be here because there's no such thing as parking on some of our major university campuses. Also, there's a factor of intimidation on the part of a small business person to go wandering on a 60-acre facility, and I personally would be intimidated with that in an environment other than academic.

The point is I think this wording probably has no ramifications because it's already in existence. Now it may have ramifications on future programs, future States that may get——

Mr. BILIRAKIS. But we're concerned about the future, too. I don't think that your program would be pulled out of the University of Georgia.

Mr. KOMIVES. I think the concern I have, as I quickly glanced at the wording, is the feeling that this is being mandated rather than saying to the SBDC operating in a State, "you have to relate to your clientele and let them figure out how best to get to their clientele under the constraints that it requires." I can envision some programs that ought to be held right on the college campus.

I was involved in one not too long ago in which a workshop on robotics was conducted. Well, you're not going to take all that equipment out of the classroom in order to take it down to a storefront to hold it there.

On the other hand, there are many other programs that clearly ought to be held where it's convenient for all the participants.

I think the SBDC already knows that, and is already operating and saying that the whole State is our campus and we'll function that way, so I would put this in as an urging but not make it mandatory for the State to deliver the service that way.

Mr. BILIRAKIS. If the entire program could be adversely affected do you think with this language to the extent practicable each center and each subcenter shall be located——

Mr. KOMIVES. It depends on how you read it. If a Philadelphia lawyer read it, he says that's mandated, and to somebody else he says, no, I'm free to do it wherever I think is best.

I don't know. I'm just saying that I think the marketplace is already functioning well and you probably don't really need to make the statement.

Mr. COWART. If I may add one comment, sir. I think that we, at least the original SBDC States, were always competing to have the biggest attendance, the best programs and that was very healthy for the national program.

To this extent and to accomplish our outreach, we always went for as many people as we could get as long as the program's quality was consistent.

This mandated our presence in the community, in the marketplace, not behind the ivy-covered walls of some campus someplace. It is inappropriate to hide behind the campus. No SBDC does that, that I'm aware of. That does not do what the program——

Mr. BILIRAKIS. But it could be looked upon as mandating any future programs that would not be connected with the university, if you will, at least to be a part of the university campus.

Mr. COWART. I'm reading that language and I agree, sir.

Mr. BILIRAKIS. I would yield at this time, Mr. Chairman. I think Mr. Daub wants to get into section 4 in more detail.

Mr. NEAL SMITH. Before we get into that, let me point out as an example where one university took a room up in the corner of an ivory tower and said this is the SBDC center and small businesses come here. It won't work. There's no use putting money in it if that's what you're going to do.

You agree with that, don't you, so it says that to the extent practicable the center, we're not talking about some individual class we're going to have, will be down on the street someplace where people can get to it. Do you all agree with that?

Mr. COWART. Yes, sir. Where services are delivered should be where they are used and that's the marketplace. Now where services are researched and developed could very well, and from which it could be managed, could very well be the campus.

Mr. NEAL SMITH. Or any place else.

Mr. BILIRAKIS. For clarification, Mr. Chairman, is not the research and development taking place in a center?

Mr. COWART. Not necessarily.

Mr. BILIRAKIS. Well, I realize not necessarily, but I mean in many instances it is now.

I guess all I'm saying, Mr. Chairman, is that we certainly don't want to come up with legislation that is going to be so gray that it may be interpreted in so many different ways it's just going to result in problems not only for us but for SBDC's and whatnot.

Mr. NEAL SMITH. I think there's a misunderstanding here because to start with universities aren't required to move their research facilities. It's understood that the school should utilize its research facilities, that's one of the main things we want to try to do, but then the university must deliver assistance to small business at some place where there is accessibility. That's the center.

Mr. DAUB. Mr. Chairman, thank you very much, and I did appreciate the contribution that you've all made for the record.

Let me ask for the record, Mr. Cowart, what do you do now?

Mr. COWART. I'm the administrator for two university centers.

Mr. DAUB. It says former director here on our witness sheet.

Mr. COWART. I'm the former director of the SBDC. I started our program in 1972 and I stayed with it for 10 years. After that time I thought some younger people should take over and do better things.

Mr. DAUB. Oh, you know age and height and gray hair and wisdom are all those things we've got to look up to and admire, or the absence thereof.

Mr. Bramblett, it says former director here. Now could you clarify for the record what you're doing now?

Mr. BRAMBLETT. I'm managing, owning, and running a computer software and hardware company.

Mr. DAUB. Out in the free enterprise?

Mr. BRAMBLETT. That's correct.

Mr. DAUB. Now let me ask——

Mr. BRAMBLETT. It's not all free, though.

Mr. DAUB. Well, compared to what, huh?

Mr. BRAMBLETT. That's true. That's very dynamic.

Mr. DAUB. Have you all read the bill?

Mr. BRAMBLETT. I've read most of it.

Mr. DAUB. I really am looking for specific comment and if you haven't read the bill I don't know that you can offer it except within the framework that you've already testified about, local control and to avoid this morass of having everything come up here and get centralized again and decided and mandated and if there are turf fights going on out there, even at that to have them all resolved in a mandated uniform way up here might tend to really obstruct the shifting of resources to meet your local needs and I gather your testimony in that regard——

I'm interested in particularly section 4 of the bill and I guess I have a concern about it. I'm not sure yet how I feel but I worry about the language being drafted that is inserted at page 3, lines 3, 4, and 5, and maybe perhaps lines 1 through 6 on page 3 as shifting somewhere, somehow, the emphasis and we're getting back up to a uniform system even if there's an argument to be resolved and that that may not ultimately resolve arguments but it might start to take on the odor of deciding that everything is going to be decided back in Washington again as to what resources would be approved and what cannot, what applications will or won't be approved, and I wonder if you feel the same way about that or if you see it differently.

Mr. Bramblett, did you say you had read the bill?

Mr. BRAMBLETT. I'm rereading it.

Mr. DAUB. You said there were some things in this bill that you wanted us to be careful of. Is that one of them?

Mr. BRAMBLETT. I don't think I can add any more to it than the fact that you must not allow opinions, idiosyncracies, and that sort of thing to, if you will, cause problems with a program and I think we can cite cases in which historically that sometimes has come up, not only this program but with other Federal programs. I think you should attempt to avoid those but not at the cost of centralizing the entire program here in Washington, DC. No, sir.

Mr. DAUB. What I'd be worried about is that while we may have an idiosyncracy problem or personality dispute at one, two, three, or four points in the total network of 35 States, it would be far worse to have that idiosyncracy be the person in Washington calling the shots that affects all 35 States.

Mr. BRAMBLETT. That is correct. That is correct.

Mr. DAUB. Does anyone else have a comment on that? I'll proceed to ask others that are coming after you because I think they will be more familiar with the bill.

Mr. NEAL SMITH. Mr. Hiler.

Mr. HILER. I have no questions.

Mr. NEAL SMITH. Probably missed John's question. To be more specific about the control provision of H.R. 5334, on page 3, line 1, after the comma, following offices, the law now starts there. The existing law reads, "An applicant may apply to participate in the program by submitting the"—the part prior to that starting on line 1 is the new language.

It says "After consulting with, but without the need to obtain the approval of, the Administration's local district office or local offices * * *."

Mr. BRAMBLETT. That's good language.

Nothing wrong with that language at all.

Mr. NEAL SMITH. Do you think that's good or not?

Mr. BRAMBLETT. Yes, sir, that's the way it's operated in the past as far as I know. It's the way it's always operated.

Mr. NEAL SMITH. So you think you ought to consult with them, but you hadn't ought to sit there and have to think that you can't possibly proceed without his approval.

Mr. BRAMBLETT. That's correct. That's good language.

Mr. DAUB. So let me ask you then if I might, would you yield, Mr. Smith?

Mr. NEAL SMITH. Yes. Go ahead.

Mr. DAUB. You do recognize that the word administration is stricken in lines 2 and 3 of page 3, deputy associate administrator for management assistance is inserted. There is a technical difference there after the word "and".

I am saying there is a change to make your comment straight, that there is another change beyond where you started there. There's the word "administration" is refined to the point where the applications or the discussion now takes place.

I would ask you if you would yield further to ask them then how they feel about the language being added after consulting but without the need to obtain the approval of the administration's local district office.

I mean what would you see be meant by that sort of—puts you on record that you don't need to mess with any discussion at the local level maybe. Is there any danger in those words?

Mr. BRAMBLETT. I am looking at that language that you just read, and no, sir, I think that language is good language.

Mr. DAUB. Why is it being added? Why would you see the need for it then if the other language is sufficient?

Mr. BRAMBLETT. I guess I would be redundant again in saying that one person, one party, cannot afford to interfere with the business of the state of economic development in our States.

That is the issue at hand here.

Mr. DAUB. So you see that language as getting rid of any troublemaker that is out there now locally standing in the way of some SBDC doing what it thinks it ought to do?

Mr. BRAMBLETT. I think the SBA needs to measure that not as a practical reality—if that happened, if that actually happened, there's one or two things going to happen. Persons and parties interested in this program are going to say the heck with it, go home, pack up their bags and spend their resources on something else, or they're going to eliminate that person regardless of the Federal employment regulations so forth and so on.

They're going to go at it another way.

Mr. DAUB. What happens if the local people commenced to interpret that new language but without the need to obtain approval of as simply not even worrying too much about any local consultation except perhaps perfunctory and simply everybody starts coming to Washington for all their approvals.

Mr. BRAMBLETT. No, I don't think you want either of the two cases to happen. Maybe two or three lines, two or three adjectives or adverbs——

Mr. DAUB. Thank you for yielding.

Mr. NEAL SMITH. Thank you all very much. You've been a very excellent panel. We took twice as long as we had time for, but it was worthwhile.

Thank you very much.

Mr. James Thomson we have your testimony. We're in a bind for time so we'll submit it for the record, and you may introduce your associate, and you can make a brief comment.

TESTIMONY OF JAMES N. THOMSON, ASSOCIATE ADMINISTRATOR FOR MANAGEMENT ASSISTANCE, SMALL BUSINESS ADMINISTRATION, ACCOMPANIED BY MS. JOHNNIE ALBERTSON AND JOHN SWEENEY, DEPUTY ASSOCIATE ADMINISTRATORS FOR MANAGEMENT ASSISTANCE, SBDC

Mr. THOMSON. Yes, sir, Mr. Chairman. My name is Jim Thomson. I am the associate administrator for management assistance, Small Business Administration. I am pleased to appear before you today to provide a report on the Small Business Development Centers and to express our support for legislation to reauthorize the SBDC program.

Accompanying me is Johnnie Albertson who is the deputy associate administrator for management assistance, SBDC's. We're submitting for the record a detailed statement on the small business development center program relating its history, its present status and detail on the operation and future plans for the program.

Due to time constraints instead of presenting a summary of our detailed statement we would like to speak directly to three amendments in the House bill which are of concern to the agency.

In the legislative proposal, Mr. Chairman, SBA opposes section 4 of the House bill which would centralize the SBDC program. The SBDC program, like nearly all of SBA's other programs has been decentralized.

Decentralization of the SBDC program was accomplished more than a year ago with full participation and support by the executive committee of the association of small business development centers including participation and support by individual SBDC directors.

The decision to decentralize a program was not made unilaterally by SBA, and it was made for the purpose of strengthening the program. SBA is currently organized in such a way that permits effective decentralization of its programs.

The roles of the central office, regional offices, and local district and branch offices are clearly reflected in its organizational structure. We believe the concept of decentralization is ideal for SBDC operations since this is a program that must be tailored to address specific local needs which vary from State to State.

Our experience, although limited, has shown substantial involvement in the program since decentralization. The role of the SBA central office is to manage the SBDC program, provide technical advice, program direction and guidance to SBA field offices.

The role of the SBA field staff is to provide local direction for operation of the program. In view of the above, the agency cannot support centralization because it is completely contrary to the agency's organization and delivery of its programs.

Decentralization improves delivery of the SBDC program as well as other SBA programs and helps to strengthen the SBA, SBDC partnership.

We are concerned about section 7 of this measure which requires SBA to contract out for a management information system to provide data on the SBDC program until October 1, 1986.

We would like to discuss the status of our in-house system. The new management assistance management information system de-

signed to include SBDC's will have the following: One, a fully electronic system that precludes the need for the presently cumbersome mailing procedures; two, a simplified reporting system that minimizes user paperwork and procedures as well as superfluous data collection; three, a uniform SBA district office and SBDC system that would foster cooperation between not only the SBA and the SBDC's but such volunteer organizations as Score/Ace; and four, a system that utilizes the SBA's already developed and paid for communications network as well as agency access, mainframe capacity.

Thus the new system will take advantage of marginal cost efficiencies and significantly reduce management information expenses while providing more information and features.

Operation was initiated in early March. While startup problems have so far been minimal, we fully intend to continue testing and refining the system throughout the rest of this fiscal year before introducing it into the SBDC's.

We also intend not only to train each SBDC in the system before startup but also to continue working with the SBDC directors to secure feedback through demonstration projects, et cetera.

While the agency has obviously concentrated a great deal of effort into redesigning this much needed new information system, we nevertheless recognize that startup problems are inevitable as they were with the CQQI pilot system.

That represents the reason why we have scheduled a lengthy test of the system in the SBA district offices. While we have considered running the SBA and the CQQI systems in parallel during the SBDC startup period the volume of paper, the diversity of input terminals and many other factors make this unfeasible. However, we have retained the option of negotiating an extension to the Georgia contract in the unlikely event that significant startup problems are encountered.

The agency has invested a considerable amount of effort and dollars in developing an information system that will play an instrumental role in meeting its internal control responsibilities.

Postponing this action until 1986 would not only significantly delay this process but greatly expand its cost as well.

SBA is opposed to section 6 of this bill which requires the agency to develop a program proposal for an on-sight biannual evaluation of each small business development center. The agency believes that center evaluations are an internal SBA function.

The agency further believes that present center evaluation activities are adequate to properly monitor the small business development center program.

These evaluation activities include: One, the financial audits conducted by the Department of Health and Human Services; two program audits conducted by the Department of Health and Human Services; three central office SBDC program office review on an annual basis; four field reviews; SBA project officer reviews a minimum of four times a year; internal control reviews a minimum of once a year; and SBA project officers required monitoring responsibility for SBDC's on a regular basis; five, agency conformance with OMB, A-123 internal control systems requirements with an empha-

sis on the strengthening of internal controls over the SBDC program.

The agency is also concerned with the additional cost this requirement would impose on the program's budget.

In summary, Mr. Chairman, we believe in and support the small business development center program. Decentralization of this program is working and doesn't need to be fixed. A broader depth of understanding and cooperation within all management assistance resources is being utilized.

As a major resource SBDC's are broader and deeper than basic business counseling and training. In this time of reindustrialization SBDC's now address areas of industrial development, international trade, small business innovative research and advanced technology.

The Small Business Administration has been mandated to manage its programs. It stands to reason that we need to press for continued authority to manage. We accept this responsibility and look forward to continued cooperation with Congress in building new vitality in our national economy.

Mr. Chairman, thank you for the opportunity to meet with you today. We will be pleased to respond to any questions you may have.

[Mr. Thomson's prepared statement follows:]

PREPARED STATEMENT OF JAMES N. THOMSON, ASSOCIATE ADMINISTRATOR FOR MANAGEMENT ASSISTANCE, SMALL BUSINESS ADMINISTRATION

MR. CHAIRMAN: I AM PLEASED TO APPEAR BEFORE YOU TODAY TO PROVIDE A REPORT ON THE SMALL BUSINESS DEVELOPMENT CENTER PROGRAM AND TO EXPRESS OUR SUPPORT FOR LEGISLATION TO REAUTHORIZE THE SBDC PROGRAM. WE, HOWEVER, BELIEVE THAT SEVERAL OF THE PROVISIONS IN THE DRAFT BILL WOULD UNDULY INTERFERE WITH SBA MANAGEMENT OF THE SBDC PROGRAM. ACCOMPANYING ME IS JOHNNIE ALBERTSON, DEPUTY ADMINISTRATOR FOR MANAGEMENT ASSISTANCE/SBDC PROGRAM.

AS YOU KNOW, ONE OF THE MOST OFTEN CITED CAUSES OF BUSINESS FAILURE IS LACK OF MANAGEMENT EXPERTISE. INCREASED ACCESS TO COUNSELING AND BETTER MANAGEMENT TOOLS ASSISTS THE VIABILITY OF SMALL BUSINESSES, AND CONTRIBUTES TO THE ECONOMIC GROWTH OF THE SMALL BUSINESS COMMUNITIES SERVED.

WE BELIEVE THAT THE SMALL BUSINESS DEVELOPMENT CENTER PROGRAM IS AN IMPORTANT PART OF OUR MANAGEMENT ASSISTANCE DELIVERY NETWORK, AND WOULD LIKE TO SHARE WITH YOU OUR VIEWS OF SBDC OPERATIONS TO DATE.

BACKGROUND AND ADMINISTRATIVE STRUCTURE

RECOGNIZING THE NEED FOR DIFFERENT TYPES OF MANAGEMENT SERVICES NOT AVAILABLE ACROSS THE BOARD IN THE SMALL BUSINESS ADMINISTRATION'S TRADITIONAL DELIVERY SYSTEM, SBA IN 1977 INSTITUTED A SMALL BUSINESS DEVELOPMENT CENTER PILOT PROGRAM TO COORDINATE AND DELIVER MANAGEMENT ASSISTANCE RESOURCES TO SMALL BUSINESSES. WITHIN THREE YEARS THE SBDC NETWORK EXPANDED TO SIXTEEN CENTERS. WE NOW HAVE SBDCS IN THIRTY STATES AND THE DISTRICT OF COLUMBIA, WITH EIGHT MORE PROJECTED IN THIS FISCAL YEAR. OVER ONE HUNDRED SIXTY COLLEGES AND UNIVERSITIES TOGETHER WITH STATE AND LOCAL DEVELOPMENT AGENCIES, CHAMBERS OF COMMERCE AND OTHER NONPROFIT INSTITUTIONS ARE PARTICIPATING IN THE SBDC NETWORK.

P.L. 96-302--SMALL BUSINESS DEVELOPMENT CENTER ACT OF 1980

ENACTMENT OF PUBLIC LAW 96-302 PROVIDED THE BASIC FRAMEWORK AND GUIDANCE FOR NATIONAL PROGRAM EXPANSION. IT ENABLED THE SMALL BUSINESS ADMINISTRATION TO FOCUS ON THE REFINEMENT OF POLICY AND OPERATIONAL PROCEDURES. WHILE THIS LAW IS BASED ON THE SBA-DESIGNED PILOT PROGRAM, IT PLACES STRONGER EMPHASIS ON THE UTILIZATION OF MULTIPLE MANAGEMENT AND TECHNICAL RESOURCES, PRIVATE MANAGEMENT CONSULTANTS, PRIVATE CONSULTING ENGINEERS, PRIVATE TESTING LABORATORIES, INNOVATION AND ASSESSMENT CENTERS, INDUSTRIAL APPLICATION CENTERS, AS WELL AS OTHER GOVERNMENT ASSISTANCE PROGRAMS AND ACADEMIC INSTITUTIONS.

MUCH OF WHAT WAS BEGUN IN THE WAY OF NEW MANAGEMENT DIRECTION OF THE SBDC PROGRAM WAS INITIATED A YEAR AND A HALF AGO AND IT IS THAT AGENCY THRUST WHICH I WOULD LIKE TO DISCUSS.

EFFECTIVE MANAGEMENT

THE CENTRAL OFFICE CONTINUES TO DIRECT ATTENTION TO IMPROVING PROCEDURES FOR EFFECTIVE PROGRAM MANAGEMENT. WE HAVE PERFORMED ONSITE REVIEWS OF 15 SMALL BUSINESS DEVELOPMENT CENTER STATE OPERATIONS THIS PAST YEAR. IN ADDITION, TRANSFER OF THE OPERATIONAL MANAGEMENT OF THE PROGRAM TO THE LOCAL LEVEL THROUGH OUR SBA FIELD OFFICES HAS REQUIRED CONSIDERABLE SUPPORT ACTIVITY FROM THE SBDC CENTRAL OFFICE STAFF. JOHNNIE ALBERTSON HAS PERSONALLY VISITED 17 SBDCS DURING THE PAST SIX MONTHS TO FACILITATE TRANSITION OF THE PROGRAM. HARDY PATTEN, DEPUTY TO MRS. ALBERTSON, HAS DIRECTED HIS FULL ATTENTION TO ASSISTING IN THE DEVELOPMENT OF NEW STATEWIDE SBDC PROGRAMS. NEW STRUCTURES FOR SERVICE DELIVERY HAVE BEEN DEVELOPED, AND WE CURRENTLY HAVE AN SBDC OPERATED BY THE DEPARTMENT OF COMMERCE AND COMMUNITY AFFAIRS IN THE STATE OF ILLINOIS. ANOTHER SBDC LOCATED IN THE STATE OF OREGON IS BEING ADMINISTERED

THROUGH THE COMMUNITY COLLEGE NETWORK. AS NEW LINKAGES ARE DEVELOPED INVOLVING THE TOTAL RESOURCES OF THE STATE, WE ARE CAREFULLY EXAMINING BOTH THE SERVICES TO BE PROVIDED BY AN SBDC AS WELL AS THE SOURCES OF MATCHING FUNDS TO ENSURE AGAINST DUPLICATION AND REPLACEMENT.

WE ARE EXPLORING VARIOUS MEANS BY WHICH WE CAN ENTER INTO MORE FORMAL ARRANGEMENTS WITH THE FEDERAL LABS CONSORTIUM, NASA, AND THE NATIONAL SCIENCE FOUNDATION TO PROVIDE NEEDED TECHNOLOGY TRANSFER TO THE SMALL BUSINESS COMMUNITY. WE HAVE CLARIFIED AND REINFORCED OUR REQUIREMENT FOR STATEWIDE SBDC OPERATIONS TO ENSURE THAT ALL PARTICIPANTS COOPERATE AND COORDINATE THEIR ACTIVITIES WITHIN THE AREA TO BE SERVED. FURTHER, EXECUTIVE ORDER 12372, "INTERGOVERNMENTAL REVIEW OF FEDERAL PROGRAMS" HAS RECENTLY BEEN IMPLEMENTED AND REQUIRES EACH SBDC TO FOLLOW A STATE PROCESS FOR REVIEW OF ITS PROPOSAL IF THE SBDC PROGRAM IS OF PRIORITY TO THE STATE. THIS POLICY WILL FURTHER OUR EFFORTS TO ENSURE STATEWIDE COORDINATION AND AVOID POSSIBLE DUPLICATION OF SERVICES. EFFORTS ARE ALSO ONGOING TO ENSURE THAT SMALL BUSINESS DEVELOPMENT CENTERS UTILIZE AND COMPENSATE QUALIFIED SMALL BUSINESS CONSULTANTS. INFORMATION INDICATING SBDC USE OF PRIVATE CONSULTANTS WILL BE PROVIDED TO THE AGENCY ON AN ONGOING BASIS. WE CONTINUE TO REQUIRE SBDCS TO MAKE SPECIAL EFFORTS TO INSURE THAT DISADVANTAGED GROUPS SUCH AS WOMEN, VETERANS, MINORITIES, AND THE HANDICAPPED ARE AWARE OF THE AVAILABILITY OF SBDC SERVICES. EXCEPT IN SPECIAL SITUATIONS WHERE A ONE-TIME ASSESSMENT FEE IS CHARGED, WE CONTINUE TO OFFER ONE-ON-ONE COUNSELING TO SMALL BUSINESS CLIENTS FREE OF CHARGE. A NOMINAL, OR BREAK-EVEN FEE IS CHARGED FOR CONFERENCES, SEMINARS AND SMALL BUSINESS WORKSHOPS.

ASSOCIATION OF SMALL BUSINESS DEVELOPMENT CENTERS

SBA HAS MAINTAINED A CLOSE WORKING RELATIONSHIP WITH THE ASSOCIATION OF SMALL BUSINESS DEVELOPMENT CENTERS TO ENSURE THAT THE CENTERS PROVIDE THE BEST POSSIBLE MANAGEMENT ASSISTANCE TO ITS CLIENTS; OUR OPEN COMMUNICATION WITH THIS GROUP IS INVALUABLE.

SPECIALIZED SERVICES

SBDCS OFFER A VARIETY OF SPECIALIZED SERVICES. THEY PROVIDE GENERAL AND TECHNICAL RESEARCH INTO SMALL BUSINESS PROBLEM AREAS AS WELL AS NEW PRODUCT INNOVATION AND ASSESSMENT SERVICES FOR SMALL BUSINESS CLIENTS. SEVERAL SBDCS OPERATE INTERNATIONAL TRADE CENTERS TO ASSESS CLIENTS' EXPORT CAPABILITIES AND ASSIST THEM IN THE DEVELOPMENT OF AN INTERNATIONAL MARKETING PLAN. MANY SBDCS OFFER BUSINESS LAW INFORMATION SERVICES TO HELP SMALL BUSINESS OWNERS IN ASSESSING THEIR NEED FOR LEGAL COUNSEL. SBDCS MAINTAIN LIBRARY AND INFORMATION SERVICES, ADDRESSING THE PARTICULAR NEEDS OF VETERANS, WOMEN AND MINORITIES; AND DISSEMINATING SMALL BUSINESS INFORMATION THROUGH VIDEO TAPES, NEWS SPOTS, NEWSLETTERS AND TOLL FREE INFORMATION LINES. SEVERAL SBDCS PROVIDE COMPUTERIZED INFORMATION RETRIEVAL SERVICES AND PROCUREMENET ASSISTANCE. SBDCS PUBLISH SMALL BUSINESS PUBLICATIONS TO GIVE PROFESSIONAL GUIDANCE TO SMALL BUSINESS OWNERS AND TO THOSE CONSIDERING GOING INTO BUSINESS.

EXPANDED PROGRAM GOALS

I WOULD LIKE TO DESCRIBE BRIEFLY OUR EXPANDED PROGRAM GOALS.

I AM SURE YOU AGREE THAT TO UTILIZE THE SMALL BUSINESS DEVELOPMENT CENTER PROGRAM PRIMARILY TO PROVIDE SERVICES THAT DUPLICATE OTHER MORE COST EFFECTIVE SBA RESOURCES IS A WASTE OF MONEY AND TALENT. WE BELIEVE THAT SBDCS SHOULD CONTINUE TO PROVIDE A BASIC TRAINING AND COUNSELING NETWORK IN CONJUNCTION WITH SBA FIELD OFFICES, AND THE SCORE AND ACE PROGRAMS. IN ADDITION, SINCE SBDCS ARE SO CLOSELY INTERTWINED WITH THE UNIVERSITY SYSTEM, WE HAVE A SPECIAL OPPORTUNITY TO TAKE ADVANTAGE OF THEIR PRESENTLY UNTAPPED SOURCES OF UNIQUE SMALL BUSINESS EXPERTISE.

WE ARE EXPLORING VARIOUS MEANS OF USING THE UNIVERSITY SYSTEM MORE EXTENSIVELY--IN ADDITION TO OUR PRESENT COOPERATION WITH SCHOOLS OF BUSINESS. WE INTEND FOR NEW SMALL BUSINESS DEVELOPMENT CENTERS TO HAVE A STRONG EMPHASIS ON TECHNOLOGY TRANSFER TO THE SMALL BUSINESS COMMUNITY. WE WANT TO INTEGRATE MORE SCHOOLS OF ENGINEERING, DEPARTMENTS OF COMPUTER SCIENCES AND OTHER SPECIALIZED AREAS OF UNIVERSITY EXPERTISE INTO THE SMALL BUSINESS DEVELOPMENT CENTER PROGRAM. THIS HAS ALREADY BEGUN.

FOR EXAMPLE, A NEW SMALL BUSINESS DEVELOPMENT CENTER BEING FORMED IN KANSAS WILL PROVIDE HIGH TECHNOLOGY ASSISTANCE TO SMALL BUSINESSES THROUGH FOUR ENGINEERING CENTERS. THESE CENTERS, ESTABLISHED BY THE KANSAS STATE LEGISLATURE, ARE LOCATED AT UNIVERSITIES PARTICIPATING WITH THE SBDC. THESE CENTERS ARE LOCATED AT KANSAS STATE UNIVERSITY, PITTSBURGH UNIVERSITY, UNIVERSITY OF KANSAS AND WICHITA STATE UNIVERSITY. THEY WILL PLACE SPECIAL EMPHASIS ON TECHNICAL ASSISTANCE TO SMALL BUSINESS.

OUR DISTRICT OFFICE IN DALLAS IS CURRENTLY WORKING WITH THE UNIVERSITY OF TEXAS AT ARLINGTON SMALL BUSINESS DEVELOPMENT CENTER WHICH IS PROVIDING A UNIQUE SOURCE OF ENGINEERING AND TECHNOLOGY ASSISTANCE TO SMALL BUSINESSES IN THE DALLAS-FORT WORTH METROPLEX AREA. BASED IN THE COLLEGE OF ENGINEERING,

THIS SMALL BUSINESS DEVELOPMENT CENTER PROVIDES VARIED, COST-EFFECTIVE ENGINEERING AND BUSINESS MANAGEMENT EXPERTISE TO TECHNOLOGY-BASED BUSINESSES IN THE DALLAS AREA. ADDITIONAL SERVICES MAKE THIS SBDC THE FOCAL POINT FOR EFFORTS BY BUSINESS, INDUSTRY AND COMMUNITY LEADERS TO ENHANCE THE HIGH TECHNOLOGY BUSINESS CLIMATE IN THE NORTH TEXAS AREA.

WE ARE DIRECTING THE SMALL BUSINESS DEVELOPMENT CENTERS TO ASSIST IN COMMUNITY ECONOMIC DEVELOPMENT. LINKAGES ARE BEING ESTABLISHED, FOR EXAMPLE, WITH THE AGENCY'S 503 LOAN PROGRAM, A SUCCESSFUL COMMUNITY ECONOMIC DEVELOPMENT PROGRAM THAT HAS RECEIVED WIDE USAGE THROUGHOUT THE COUNTRY. WORKING WITH THE CERTIFIED DEVELOPMENT COMPANIES THAT ARE AN ESSENTIAL PART OF THE SUCCESSFUL OPERATION OF THIS PROGRAM, SMALL BUSINESS DEVELOPMENT CENTERS WILL PROVIDE THE TECHNICAL AND MANAGEMENT ASSISTANCE EXPERTISE THAT WILL MAKE THIS ALREADY SUCCESSFUL PROGRAM A SOLID ACCOMPLISHMENT IN THE PARTNERSHIP BETWEEN GOVERNMENT AND THE PRIVATE SECTOR.

MANY SMALL BUSINESS DEVELOPMENT CENTERS ARE MOVING AHEAD AS FULL PARTICIPANTS IN SBA'S NEW SMALL BUSINESS INNOVATION RESEARCH PROGRAM. THE SBDC LOCATED AT ST. LOUIS UNIVERSITY, THROUGH ITS CONSORTIUM SCHOOLS OF THE UNIVERSITY OF MISSOURI, IS HEAVILY INVOLVED IN TRAINING AND MANAGEMENT ASSISTANCE IN THIS IMPORTANT PROGRAM FOR SMALL BUSINESS INNOVATION AND RESEARCH. A MODEL FOR SBDCS TO DELIVER THESE SERVICES ON A NATIONWIDE BASIS IS CURRENTLY BEING DEVELOPED IN COORDINATION WITH SBA AND THE SMALL BUSINESS DEVELOPMENT CENTER AT BRYANT COLLEGE IN RHODE ISLAND. WHEN THIS MODEL IS COMPLETED, IT WILL BE TESTED IN TWO OR THREE STATES AND THEN REFINED AND EXTENDED TO ALL PARTICIPATING SBDCS, AS WELL AS NEW SBDCS ENTERING THE PROGRAM.

THESE ARE EXAMPLES OF WHAT WE CONSIDER TO BE A NECESSARY DIRECTION OF THE SMALL BUSINESS DEVELOPMENT CENTER PROGRAM--A FULL UTILIZATION OF THE TOTAL RESOURCES OF THE UNIVERSITY AND THE STATE AND THE HIGHLY SPECIALIZED TALENT AND KNOWLEDGE THAT EACH OF OUR SBDCS AND THEIR SUBCENTERS CAN PROVIDE FOR ASSISTANCE TO CLIENTS AND COMMUNITIES WE SERVE. WORKING WITH THE LEADERSHIP OF THE SMALL BUSINESS DEVELOPMENT CENTER DIRECTORS' ASSOCIATION, WITH OUR COMPETENT SBA FIELD PEOPLE, WITH THE DEDICATED VOLUNTEER SERVICES OF OUR SCORE AND ACE PERSONNEL, WE ARE CONFIDENT THAT THE FULL RANGE OF POTENTIAL ASSISTANCE TO THE SMALL BUSINESS COMMUNITY CAN BE EFFECTIVELY DELIVERED. WE WELCOME ANY SUGGESTIONS YOU MAY HAVE IN THIS REGARD.

LEGISLATIVE PROPOSALS

MR. CHAIRMAN, WE WOULD LIKE TO COMMENT ON THE HOUSE BILL WHICH PROPOSES SEVERAL AMENDMENTS TO EXISTING LAW. THESE COMMENTS ARE BASED ON A DRAFT WHICH WAS GIVEN TO THE AGENCY ON MARCH 29.

SBA OPPOSES SECTION 4 OF THE HOUSE BILL WHICH WOULD CENTRALIZE THE SBDC PROGRAM.

THE SBDC PROGRAM, LIKE NEARLY ALL OF SBA'S OTHER PROGRAMS, HAS BEEN DECENTRALIZED.

DECENTRALIZATION OF THE SBDC PROGRAM WAS ACCOMPLISHED MORE THAN A YEAR AGO WITH FULL PARTICIPATION AND SUPPORT BY THE EXECUTIVE COMMITTEE OF THE ASSOCIATION OF SMALL BUSINESS DEVELOPMENT CENTERS, INCLUDING PARTICIPATION AND SUPPORT BY INDIVIDUAL SBDC DIRECTORS. THE DECISION TO DECENTRALIZE THE PROGRAM WAS NOT MADE UNILATERALLY BY SBA, AND IT WAS MADE FOR THE PURPOSE OF STRENGTHENING THE PROGRAM. SBA IS CURRENTLY ORGANIZED IN SUCH A WAY THAT PERMITS EFFECTIVE DECENTRALIZATION OF ITS PROGRAMS. THE ROLES OF THE CENTRAL OFFICE, REGIONAL OFFICES AND LOCAL DISTRICT AND BRANCH OFFICES ARE CLEARLY REFLECTED IN ITS ORGANIZATIONAL STRUCTURE.

WE BELIEVE THE CONCEPT OF DECENTRALIZATION IS IDEAL FOR SBDC OPERATIONS SINCE THIS IS A PROGRAM THAT MUST BE TAILORED TO ADDRESS SPECIFIC LOCAL NEEDS WHICH VARY FROM STATE TO STATE. OUR EXPERIENCE, ALTHOUGH LIMITED, HAS SHOWN SUBSTANTIAL IMPROVEMENT IN THE PROGRAM SINCE DECENTRALIZATION. THE ROLE OF THE SBA CENTRAL OFFICE IS TO MANAGE THE SBDC PROGRAM, PROVIDE TECHNICAL ADVICE, PROGRAM DIRECTION AND GUIDANCE TO SBA FIELD OFFICES. THE ROLE OF THE SBA FIELD STAFF IS TO PROVIDE LOCAL DIRECTION FOR OPERATION OF THE PROGRAM.

IN VIEW OF THE ABOVE, THE AGENCY CANNOT SUPPORT CENTRALIZATION BECAUSE IT IS COMPLETELY CONTRARY TO THE AGENCY'S ORGANIZATION AND DELIVERY OF ITS PROGRAMS. DECENTRALIZATION IMPROVES DELIVERY OF THE SBDC PROGRAM AS WELL AS OTHER SBA PROGRAMS, AND HELPS TO STRENGTHEN THE SBA/SBDC PARTNERSHIP.

WE ARE CONCERNED ABOUT SECTION 7 OF THIS MEASURE WHICH REQUIRES SBA TO CONTRACT OUT FOR A MANAGEMENT INFORMATION SYSTEM TO PROVIDE DATA ON THE SBDC PROGRAM UNTIL OCTOBER 1, 1986. WE WOULD LIKE TO DISCUSS THE STATUS OF OUR IN-HOUSE SYSTEM. THE NEW MANAGEMENT ASSISTANCE MANAGEMENT INFORMATION SYSTEM DESIGNED TO INCLUDE SBDCS WILL HAVE THE FOLLOWING:

1) A FULLY ELECTRONIC SYSTEM THAT PRECLUDES THE NEED FOR THE PRESENTLY CUMBERSOME MAILING PROCEDURES.
2) A SIMPLIFIED REPORTING SYSTEM THAT MINIMIZES USER PAPERWORK AND PROCEDURES AS WELL AS SUPERFLOUS DATA COLLECTION.
3) A UNIFORM SBA DISTRICT OFFICE AND SBDC SYSTEM THAT WOULD FOSTER COOPERATION BETWEEN NOT ONLY THE SBA AND THE SBDCS BUT SUCH VOLUNTEER ORGANIZATIONS AS SCORE/ACE.

4) A SYSTEM THAT UTILIZES THE SBA'S ALREADY DEVELOPED AND PAID FOR COMMUNICATIONS NETWORK AS WELL AGENCY EXCESS MAINFRAME CAPACITY. THUS, THE NEW SYSTEM WILL TAKE ADVANTAGE OF MARGINAL COST EFFICIENCIES AND SIGNIFICANTLY REDUCED MANAGEMENT INFORMATION EXPENSES WHILE PROVIDING MORE INFORMATION AND FEATURES.

OPERATION WAS INITIATED IN EARLY MARCH. WHILE START-UP PROBLEMS HAVE SO FAR BEEN MINIMAL, WE FULLY INTEND TO CONTINUE TESTING AND REFINING THE SYSTEM THROUGHOUT THE REST OF THIS FISCAL YEAR BEFORE INTRODUCING IT INTO THE SBDC'S. WE ALSO INTEND NOT ONLY TO TRAIN EACH SBDC IN THE SYSTEM BEFORE ITS START-UP BUT ALSO TO CONTINUE WORKING WITH THE SBDC DIRECTORS TO SECURE FEEDBACK THROUGH DEMONSTRATION PROJECTS, ETC.

WHILE THE AGENCY HAS OBVIOUSLY CONCENTRATED A GREAT DEAL OF EFFORT INTO REDESIGNING THIS MUCH NEEDED NEW INFORMATION SYSTEM, WE NEVERTHELESS RECOGNIZE THAT START-UP PROBLEMS ARE INEVITABLE - AS THEY WERE WITH THE CQQI PILOT SYSTEM. THAT REPRESENTS THE REASON WHY WE HAVE SCHEDULED A LENGTHY TEST OF THE SYSTEM IN THE SBA DISTRICT OFFICES. WHILE WE HAVE ALSO CONSIDERED RUNNING THE SBA AND THE CQQI SYSTEMS IN PARALLEL DURING THE SBDC START-UP PERIOD, THE VOLUME OF PAPER, THE DIVERSITY OF INPUT TERMINALS AND MANY OTHER FACTORS MAKE THIS INFEASIBLE.

HOWEVER, WE HAVE RETAINED THE OPTION OF NEGOTIATING AN EXTENSION TO THE GEORGIA CONTRACT IN THE UNLIKELY EVENT THAT SIGNIFICANT START-UP PROBLEMS ARE ENCOUNTERED.

IN CONCLUSION, THE AGENCY HAS INVESTED A CONSIDERABLE AMOUNT OF EFFORT AND DOLLARS IN DEVELOPING AN INFORMATION SYSTEM THAT WILL PLAY AN INSTRUMENTAL ROLE IN MEETING ITS INTERNAL CONTROL RESPONSIBILITIES. POSTPONING THIS ACTION UNTIL 1986 WOULD NOT ONLY SIGNIFICANTLY DELAY THIS PROCESS BUT GREATLY EXPAND ITS COST AS WELL.

THE AGENCY SUPPORTS SECTION 1 OF THE PROPOSAL TO ESTABLISH TWO UNIFORM CONTRACT RENEWAL CYCLES FOR SBDCS COINCIDING WITH THE CALENDAR YEAR AND THE FEDERAL FISCAL YEAR BUT DOES NOT BELIEVE THAT A STATUTORY PROVISION IS NECESSARY NOR ADVISABLE. OUR PLAN IS THAT NEW SBDCS ENTERING THE PROGRAM BE FUNDED IMMEDIATELY UPON APPROVAL OF THEIR APPLICATION BY SBA. WE WOULD THEN PROCEED TO ADJUST THE TERM OF THEIR GRANT TO COINCIDE WITH EITHER THE CALENDAR OR FISCAL YEAR DURING THE SECOND FUNDING CYCLE.

THE AGENCY SUPPORTS SECTION 2 OF THE BILL TO ENSURE THE PROVISION OF APPROPRIATE MATCHING FUNDS BY SBDC APPLICANTS. THE LANGUAGE INCLUDED IN THE HOUSE BILL, HOWEVER, WOULD HAVE A SIGNIFICANT IMPACT ON SBDC OPERATIONS. SEVERAL SBDCS ARE CURRENTLY MEETING THE MATCH REQUIREMENT WITH LESS THAN FULL-TIME SALARIES. BECAUSE OF THE CLEAR POTENTIAL FOR IMPACT ON ONGOING OPERATIONS, WE WOULD LIKE TO RECOMMEND THAT ANY CHANGES TO EXISTING LAW BE PHASED IN TO ALLOW THOSE SBDCS AFFECTED AMPLE TIME TO PURSUE OTHER SOURCES OF MATCHING FUNDS.

THE AGENCY SUPPORTS THE INTENTION OF SECTION 5 OF THE BILL WHICH WOULD AMEND CURRENT LANGUAGE TO ENSURE THAT SBDCS ARE HOUSED IN ACCESSIBLE LOCATIONS, AS WELL AS THE REQUIREMENT FOR FULL-TIME DIRECTION AT BOTH THE LEAD SBDC AND THE SUBCENTERS. WE BELIEVE THESE ARE IMPORTANT STEPS TOWARD ENSURING EFFECTIVE PROGRAM LEADERSHIP THROUGHOUT THE SBDC NETWORK BUT DO NOT BELIEVE THAT STATUTORY LANGUAGE IS APPROPRIATE.

SBA IS OPPOSED TO SECTION 6 OF THIS BILL WHICH REQUIRES THE AGENCY TO DEVELOP A PROGRAM PROPOSAL FOR AN ONSITE BIANNUAL EVALUATION OF EACH SMALL BUSINESS DEVELOPMENT CENTER.

THE AGENCY BELIEVES THAT CENTER EVALUATIONS ARE AN INTERNAL SBA FUNCTION. THE AGENCY FURTHER BELIEVES THAT PRESENT CENTER EVALUATION ACTIVITIES ARE ADEQUATE TO PROPERLY MONITOR THE SMALL BUSINESS DEVELOPMENT CENTER PROGRAM. THESE EVALUATION ACTIVITIES INCLUDE:

1. FINANCIAL AUDITS CONDUCTED BY THE DEPT. OF HEALTH AND HUMAN SERVICES
2. PROGRAM AUDITS CONDUCTED BY THE DEPT. OF HEALTH AND HUMAN SERVICES
3. CENTRAL OFFICE, SBDC PROGRAM OFFICE REVIEWS--ON AN ANNUAL BASIS
4. FIELD REVIEWS:
   a) SBA PROJECT OFFICER REVIEWS--MINIMUM OF 4 TIMES A YEAR
   b) INTERNAL CONTROL REVIEWS--MINIMUM OF ONCE A YEAR
   c) SBA PROJECT OFFICER'S REQUIRED MONITORING RESPONSIBILITY FOR FOR SBDCS--ON A REGULAR BASIS
5. AGENCY CONFORMANCE WITH OMB A-123, INTERNAL CONTROL SYSTEM REQUIREMENTS WITH AN EMPHASIS ON THE STRENGTHENING OF INTERNAL CONTROLS OVER THE SBDC PROGRAM.

THE AGENCY IS ALSO CONCERNED WITH THE ADDITIONAL COST THIS REQUIREMENT WOULD IMPOSE ON THE PROGRAM'S BUDGET.

IN ADDITION TO THE RECOMMENDED CHANGES INCLUDED IN THE HOUSE BILL, I WOULD LIKE TO MAKE THE FOLLOWING COMMENTS:

SENATE-PASSED REVISION

WE BELIEVE THAT THE REQUIREMENT FOR FOUR NATIONAL SMALL BUSINESS DEVELOPMENT CENTER ADVISORY BOARD MEETINGS A YEAR IS EXCESSIVE AND THAT THE SMALL BUSINESS DEVELOPMENT CENTER ADVISORY BOARD COULD PROVIDE VALUABLE SBDC PROGRAMMATIC GUIDANCE THROUGH BIANNUAL MEETINGS. THE STAFF TIME REQUIRED TO

ARRANGE THESE MEETINGS AND PROVIDE THE NECESSARY ADMINISTRATIVE SUPPORT ONLY SERVES TO DIMINISH THE CONTRIBUTION OF THE BOARD. THE AGENCY RECOGNIZES THE VALUABLE CONTRIBUTIONS BEING MADE BY THE NATIONAL ADVISORY BOARD, AND SUPPORTS THE AMENDMENT REQUIRING THE BOARD TO MEET BIANNUALLY, OR AT THE REQUEST OF THE DEPUTY ASSOCIATE ADMINISTRATOR FOR MANAGEMENT ASSISTANCE/SBDC PROGRAM.

WE RECOMMEND THAT THE STATUTE CLEARLY STATE THE SMALL BUSINESS DEVELOPMENT CENTER ADVISORY BOARD MEMBERS BE REIMBURSED ONLY FOR TRAVEL EXPENSES. P.L. 96-302 STATES THAT SMALL BUSINESS DEVELOPMENT CENTER ADVISORY BOARD MEMBERS ARE ENTITLED TO BE COMPENSATED AT THE GS-18 RATE FOR EACH DAY ENGAGED IN BOARD ACTIVITIES. SBA FUNDS ARE NOT ADEQUATE TO ALLOW FOR PAYMENT OF ADVISORY BOARD MEMBERS, AND SBA POLICY FOR ALL OTHER INTERNAL ADVISORY BOARDS, SUCH AS THE NATIONAL ADVISORY COUNCIL, HAS BEEN THAT REIMBURSEMENT WILL BE PROVIDED FOR EXPENSES IN CONNECTION WITH TRAVEL ACTIVITIES ONLY.

MR. CHARIMAN, WE WOULD ALSO LIKE TO TAKE THIS OPPORTUNITY TO URGE FAVORABLE CONSIDERATION OF A BILL CONGRESSMAN MCDADE HAS INTRODUCED, H.R. 2537, WHICH WILL HELP US ESTABLISH A MORE EFFICIENT MANAGEMENT ASSISTANCE LINK BETWEEN THE PRIVATE SECTOR AND THE FEDERAL GOVERNMENT. SBA IS NOW PROHIBITED FROM COOPERATING WITH PROFITMAKING ORGANIZATIONS IN PROVIDING COUNSELING, TRAINING AND OTHER VARIETIES OF MANAGEMENT ASSISTANCE.

THIS LEGISLATION WOULD PERMIT US TO COOPERATE WITH PROFITMAKING ORGANIZATIONS IN THIS RESPECT. FOR EXAMPLE, IN THE FIELDS OF COMPUTER TECHNOLOGY AND COMMUNICATIONS, ALMOST ALL RESOURCES ARE CONCENTRATED IN PROFITMAKING FIRMS. A MAJOR THRUST IN THESE AND OTHER "HIGH TECH" FIELDS IS TOWARDS SMALL BUSINESSES IN THESE CRUCIAL FIELDS. ACCESS TO THE REVOLUTION IN INFORMATION SCIENCE WILL MAKE THE DIFFERENCE IN SURVIVAL OR FAILURE OF MANY SMALL BUSINESSES.

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IN SUMMARY, MR. CHAIRMAN, WE SHARE WITH YOU THE GOAL OF PROVIDING EXCELLENT MANAGEMENT ASSISTANCE SERVICES TO THE SMALL BUSINESS COMMUNITY. WE STRONGLY SUPPORT YOUR EFFORTS TO REAUTHORIZE THE SBDC PROGRAM AND CONCUR WITH THE INTENT OF THE BILL. HOWEVER, WE CURRENTLY ARE CARRYING OUT SEVERAL OF YOUR GOALS WITHIN THE EXISTING LEGISLATION AND ARE CONCERNED THAT SEVERAL OF THE PROPOSED NEW PROVISIONS WILL ADD UNNECESSARY COST AND ADMINISTRATIVE BURDEN WITHOUT ANY REAL INCREASE IN EFFECTIVENESS. WE LOOK FORWARD TO CONTINUED COOPERATION WITH CONGRESS IN THIS ENDEAVOR WHICH IS VITAL TO A HEALTHY NATIONAL ECONOMY.

Mr. NEAL SMITH. I am not quite clear why you are opposed to what amounts to be a peer review of a development center by other people from other development centers.

Mr. THOMSON. We feel that we have monitoring in place that does an adequate——

Mr. NEAL SMITH. You'd rather your in-house SBA people do it without other people from other development centers helping to evaluate?

Mr. THOMSON. Well, we certainly have the outside areas of health and human services in monitoring activities as well, sir.

Mr. SMITH. Mr. Daub?

Mr. DAUB. Mr. Chairman, I have just a couple of questions. First, I'd like you to tell me if you would object if report language were worked out by this committee that said we had no objection to the section 7—not the contract—the computer program. That is—what section is that—6 and 7—until you get one system tested up and running, you don't just band in one before the other one is fully tested.

Would that be an acceptable way rather than attempt to say yes or no to what you're really trying to tell us in your testimony.

Mr. THOMSON. Yes, sir, I think what we have said here basically is that in case there is a potential glitch down the road that we would open up the opportunity for extension in the program.

Mr. DAUB. In other words you're saying that you don't have to continue to contract out if you prove to us your system works.

Mr. THOMSON. That's correct, and we have a system that has started in March. We'll have a second part of the system that will be on board in June. The SBDC's will be incorporated at the beginning of the next fiscal year on October 1.

We don't see problems at this particular period of time, and we will be going through a training process with the SBDC personnel.

Mr. DAUB. You can appreciate why this committee wants to be careful and be assured that we ultimately have reliability of delivery when we transition into what appears to me to be a very workable and very innovative approach to getting the information out that we want to get out, but we want to be careful.

Mr. THOMSON. We understand you completely.

Mr. DAUB. All right. Tell me what you think about my discussion with your previous panel. You were here and you heard it relative to the first three or four lines of subsection 2 of section 4 on page 3 of the bill, and perhaps Ms. Albertson would comment if section 4 or any part of it gives you any concern. You do administer these programs now, do you not?

Ms. ALBERTSON. Yes, I do. I occupy the position which was created by the legislation, the deputy associate administrator for management assistance of SBDC programs.

I have occupied that position for about a year-and-a-half, and it was my management decision with the consent of course, of the administrator of the agency to decentralize the program.

The decentralization of the program was done in order to get more local input into the program and to be sure that the coordination of the activities of the SBDC had more investment in it from the district offices.

The chairman referred earlier to the fact that there was a great deal of hostility about the SBDC program at the beginning of its life and its administration by the agency. That hostility was probably created primarily because of two factors.

No. 1, the overt proposals that were being put forth at that time were that the SBDC would replace the management assistance capability in the SBA district office. Nobody likes to know that somebody is being put into business to put them out of a job. So the hostility of the district office, though maybe not acceptable, was understandable in terms of the management assistance.

It was my decision to decentralize the program because people who have some investment in what is going on in terms of their job responsibilities and their job activities are apt to be more supportive than people who are just sort of cut out of the pattern.

I did not intend at any time that the district office be other than an operational charge, Mr. Daub, of the program. I intended that they be in a position to sit down with the SBDC director and that is at the district director's level or the level of the assistant district director for management assistance, and that they mutually work out the problems of the small business communities in their States, and that they do the sorts of things to make certain that there was not duplication of effort. For example, they could know that the SCORE people were doing one thing and the SBDC was doing the things that it could do best, and that they could come to a cooperative agreement, which is how the program is delivered, about what was to be done for the small businesses and their State.

Some reference was made this morning to the fact that the district director is a "career track employee," and I don't see anything wrong with that. I would say in the State of Nebraska the District Director, Rick Budd, has as much interest in what the small businesses need in the State of Nebraska as Bob Bernier, the SBDC Director, and I think they work very well together.

The problems that have been created with that have been that there have been some personalities, both on the SBDC side and the SBA side, which have collided. I know of at least four such problems. There are problems and there are difficulties.

Mr. DAUB. How do you overcome them? Somebody get fired if they don't sit down and talk, or is there a mechanism already in the law that already resolves that ultimately, or what happens?

Ms. ALBERTSON. There is a solution in the organizational structure of the agency. Those district directors report to the regional administrator, and the regional administrators report to Jim Sanders, our administrator. Mr. Thompson who is the associate administrator for management assistance reports to Mr. Sanders, so in that organizational structure there ought to be adequate ways to work out the problem.

Mr. DAUB. So what is wrong with section 4?

Ms. ALBERTSON. It cuts the district director and the district office out of some determination of what, in my view, ought to be the operation and productive activities of the SBDC.

Mr. DAUB. What lines in the new section 4 do that though if, in fact, the bulk of, for example, section 3 as the Chair pointed out a minute ago are already in the law?

Ms. ALBERTSON. Let me find the place.

The standard operating procedures which were instituted as part of the decentralization project say the district director must approve the SBDC proposal.

Mr. DAUB. Do you have a set of those standard operating procedures with you here today?

Ms. ALBERTSON. Yes, I do.

Mr. DAUB. With the chairman's position I'd like those to be made a part of the record. May I ask you whether those were approved by the SBDC executive directors and their association?

Ms. ALBERTSON. Yes, they were, and the process of putting them together was done with an enormous amount of input from the SBDC directors' association working with the executive committee, and then a copy was sent to each SBDC director before they were implemented by the agency.

Mr. DAUB. Let me ask you this question. Do you think there is a little turf protection going on now that the program has blossomed and worked well, and that some of these people that are running these SBDC's now see themselves as able to set up a domain and protect it and they feel that they now have a line to the top and they want to avoid any changes that may come with shifting resource requirements at the local level? Why is there a contention over this, and if they support section 4 in its present written form, what in it is the problem?

What in section 4 is the problem from your point of view?

Ms. ALBERTSON. I don't impugn bad motives to the SBDC directors, and I think that we've had some problems that have been hard to resolve. There are areas in which, as I say, the personalities have been very difficult, and in which we haven't been able to resolve problems in as speedy and expeditious a way probably as the SBDC director would like to have had.

My view is that those problems can be worked out within the system.

Mr. DAUB. What language in section 4 is it that is objectionable.

Ms. ALBERTSON. As far as I am concerned the phrase "without the need to obtain the approval of the Administration's local district office or local office——"

Mr. DAUB. So the SOP now requires——
Ms. ALBERTSON. That's right. That's right.
Mr. DAUB. That approval be gotten?
Ms. ALBERTSON. That's correct.
Mr. DAUB. Not in the statute but in the SOP.
Ms. ALBERTSON. That's correct.
Mr. DAUB. So what is attempting to be done now is that essentially this language then is trying to make an end run around the department's own facilitating paperwork which is called an SOP.
Ms. ALBERTSON. That's correct.
Mr. DAUB. And that is really what is being objected then by the SBDC people or——
Ms. ALBERTSON. That's correct.
Mr. DAUB. Or some of them who we'll hear from them in a minute in the next panel.
Ms. ALBERTSON. Yes, and I think also, if I may say this, that I have had, I believe, a very good working relationship with the SBDC Directors' Association. My style of management in the program—because it is, I think, a very creative and enormously exciting program in terms of its potential to do the job out there, has been one of complete openness and consensus and not doing anything that was sort of laid on the SBDC without their full knowledge and consent and lots of discussion.
When this problem of the district office surfaced—the first time it really surfaced in any official way—was 2 weeks ago in a meeting with the executive committee of the SBDC directors.
At that time I recommended to them that maybe if the SOP and the decentralization of the program was not working correctly or not working as smoothly as we would like it to, and sometimes it takes a while to get these glitches sort of ironed out, that we would meet as early as possible, probably in early June with the executive committee of the SBDC directors, with a representative group of our field people including some district directors, and we'd take a 4-day meeting and see if we couldn't iron out the SOP language that would make it more responsive to problems that are developing in the system.
So I don't think we need a legislative mandate to do what I really consider to be my job.
Mr. DAUB. I have no more questions, Mr. Chairman. I do want to conclude with a comment, and that is that it makes eminently good sense to view it in my view the way you do but at the same time we want to make sure that the program continues to be decentralized in its impact.
It seems to me penny-wise and pound-foolish that there is a rush to judgment underway here, and I, for one, haven't heard enough about section 4 to be convinced that it ought to be a part of the markup this afternoon, so I am going to be very interested.
I serve the next panel notice for very specific reasons why section 4 ought to be included in this bill rather than giving some flexibility to the two groups to work out their differences and run this program the way it ought to be run, so I appreciate Mr. Chairman, this panel, and the administration's view. Thank you.
Mr. NEAL SMITH. Let me ask you a question to follow up. Why do you favor giving an absolute veto to the district director?

Ms. ALBERTSON. I don't think I would characterize it as an absolute veto. I say that the district director must approve the proposal. That was based on the fact that the district director, who was responsible for the agency's delivery of programs, had not been supportive of the SBDC programs in my view.

As I say I am speaking from my vast experience of 2 years, Mr. Chairman, but if I may continue?

Mr. NEAL SMITH. Yes.

Ms. ALBERTSON. If the district director was going to be responsive and responsible for the program he had to have some authority to deal with what the SBDC was going to do out there. Nobody wants to feel powerless in terms of any organization over which they are supposed to have some responsibility.

Mr. NEAL SMITH. Now under this language if somebody tried to bypass the district director you would just tell them, hey, look, you haven't done enough consulting out there, so I am not going to approve it until you go do some more consulting.

Ms. ALBERTSON. Then we get into the definition of what is consulting. The SBDC director could say, "Well, I called him up and talked to him about it." I see no reason, if I may say this, Mr. Chairman, and maybe I am speaking from a——

Mr. NEAL SMITH. The real culprit is your SOP language that gives an absolute veto to that district director. Why don't you change it. Why are you waiting? Why don't you change it?

Ms. ALBERTSON. Because I want to work it out so that the district director is still involved. I don't want to cut him out of the system. He's responsible.

Mr. NEAL SMITH. Well, doesn't this keep him involved and if you think they'd come to you too fast, all you have to say is that I am not going to handle this until you go back and talk to the district directors some more.

What's wrong with that? You're the ultimate authority.

Ms. ALBERTSON. People like to feel they have some say over what's going on in their district. For example, if Conrad Lawler, district director in Des Moines, came to me as he did 1½ years ago, saying he could not tolerate the SBDC's not having a successful location, he needs to be able to negotiate that.

He felt, Mr. Chairman, that his only way to get the SBDC to come forth with the right kind of location despite the fact that he and Dave Swanson, the Iowa SBDC director, are good friends and I am good friends with Dave Swanson, was to say that if you, Dave, don't get a better location we're not going to approve this proposal.

It is a negotiating kind of position. If we can give the same kind of negotiating weight to the SBDC directors, I think it will be a good balance.

Mr. DAUB. Will the chairman yield?

Mr. NEAL SMITH. Yes.

Mr. DAUB. Do you really have the authority ultimately to do what the chairman suggests? Don't you just have a policy role to play currently, and if the SBA director wants to thumb his nose at you, he can, right now the way things are?

Ms. ALBERTSON. The major relationship in my view is the relationship between the SBDC director and the district office. That is where the service is delivered——

Mr. DAUB. But you don't, really, that is my point. You don't get involved in that really, do you?

Ms. ALBERTSON. In a negotiating stance I have.

Mr. DAUB. But you can't dictate a choice if somebody is deciding that they're not going to play ball, right?

Ms. ALBERTSON. No, I cannot.

Mr. THOMSON. Mr. Chairman, if I may add, I think there is enough commonality out there with our district directors and our district offices with SBDC's to understand the complexities of their particular State and geographical area to work this problem out and I think if there have been problems, I think they have been rather minimal in this very fast-growing program.

We see tremendous results coming in from the SBDC program, and that is why we we are extremely supportive of what is happening.

Mr. NEAL SMITH. And I am appreciative of the change not in your personally but of the Small Business Administration, and I think it's working very good in almost all cases, but I have a little trouble seeing that we should have 51 dictators out there saying either you do it my way or this is not going anywhere. Now this just can't be tolerated.

Ms. ALBERTSON. Wouldn't you rather have 51 than have one? I mean if this centralizes the program from the district to the central office.

Mr. NEAL SMITH. Well, there are ways of getting at you if you are unreasonable, you know, but not at that district director.

Ms. ALBERTSON. Ways other than what are occurring presently I gather is what you're saying.

Mr. BILIRAKIS. Would the gentleman yield a moment? Consistent with your questioning, sir, is there no review authority, no appeal review authority? The district director under your current SOP is basically it?

Ms. ALBERTSON. No, sir, we have and do exercise review authority in the central office. We review each of the proposals. If we feel that the district director is out of line, we talk with him. If we feel that the SBDC director is out of line, we talk with him.

That is still our function. We have the national responsibility for the program.

Mr. BILIRAKIS. Can an applicant who is rejected, let's say or feels he is not getting an adequate hearing, adequate day in court, so to speak, does that applicant have review authority to come up here to you?

Ms. ALBERTSON. Yes, but we still wish concurrence at the district level. We cannot proceed with it unless we can get the people together and get the concurrence at the district level. It is delivered at the district level. It ought to be approved at that level.

Mr. BILIRAKIS. I don't know what we're going to hear from the next panel, but as I understand it there are some problems down at the district level, and the SBDC seem to feel that they just don't have adequate review authority and that is the reason I suppose for this legislation, which may or may not be necessary. I don't know.

I am very anxious, Mr. Chairman, to hear the next panel. Hopefully we'll get candid comments from them.

Thank you very much.

Mr. HILER. Is it my time?

My time, Mr. Chairman? Thank you.

It seems to me after reading section 4 and listening to some of the discussion—all of your discussion and some of the discussion in the last panel, admittedly not all of it or probably not the preponderance of it—it seems that there are two entirely different approaches.

I mean the language here isn't just a little simple modification. It is either you're going to have your district directors do it or you're going to have Washington do it, and it's not as though we're just enhancing the current system. It is a 180 degree turn. Is that the way you would interpret it?

Ms. ALBERTSON. Yes.

Mr. HILER. As I read: "After consulting with but without the need to obtain approval of," that is bureaucratize, for you can do an end run as I interpret it, which is entirely different than the way the program currently operates.

Ms. ALBERTSON. That's correct.

Mr. HILER. So it is basically a philosophical question to some extent?

Ms. ALBERTSON. Yes.

Mr. HILER. OK. On section 7 let me see if I understand this correctly. For developing a management development system you currently subcontract out. Is that correct?

Ms. ALBERTSON. That's correct.

Mr. HILER. What you're trying to do is to develop an in-house computer system to basically provide the same or enhanced information.

Ms. ALBERTSON. Actually, what we've had, Congressman Hiler, has been two systems. We've had the CQQI system being funded through the University of Georgia which dealt only with management information from the SBDC.

At the same time we've had a second system, a management information system which dealt only with the other management assistance programs.

What we are seeking to do with our new management information system is combine those two systems. The CQQI system from the University of Georgia which has been in existence for 4 or 5 years is costing the agency about $350,000 a year to maintain that, and we have some costs, of course, associated with the other system.

What we're trying to do is bring the two systems together so that we will only have one cost and one system.

Mr. HILER. Now if I understand correctly your objection to section 7 is in the language implementation of any such change will not occur prior to October 1, 1986?

Ms. ALBERTSON. Yes, you see, what is going to happen is because we're already into this process and we've been into this process for a considerable length of time, we have lines already purchased. We've got the system up and running in certain sections and part of our programs, and if we have to wait until October 1, 1986 we're going to be sitting there with a fully-funded, fully-paid for management information system that we can't use.

What we're seeking is something that will permit us to if necessary, come and talk to you about it but not to delay it.

Mr. HILER. You don't have any problem with the language, "nor until such time as the administration evaluates the cost-effectiveness of the change."

Ms. ALBERTSON. Well——

Mr. THOMSON. Could I ask, Mr. Chairman, if John Sweeney who is the Deputy Associate Administrator for Management Assistance who is involved very much in the MIS system and areas of activity in MA other than SBDC to answer that particular question.

Mr. HILER. If I could ask a question of the chairman before you answer that question. In reading this language more closely, is this language saying that in no case will the exchange occur until October 1, 1986 and then only if the administration evaluates the cost-effectiveness.

Mr. NEAL SMITH. That's right, you've got to have a cost-effective evaluation in which they can't have until October 1.

Mr. HILER. That's what we are saying in no case before October 1, and only then if the administration evaluates the cost effectiveness. OK. Could you comment on that then?

Mr. SWEENEY. Yes, sir. We understand that the wording of this bill is such that we will not be able to start up a new system until after 1986.

On the cost-effectiveness question, sir, the new combined system which we believe will give enhanced capabilities to both internal and SBDC MA activities will cost as a whole less than just the SBDC system itself does now.

Mr. DAUB. I don't really understand why we're legislating in-house management. I have a real problem with that language the way it is written.

Section 6 on the biannual evaluation. It is the agency's viewpoint that you already have enough evaluations that are taking place without the need for one more.

Ms. ALBERTSON. Yes, we do, and also the language and scope of the kind of evaluation that is being proposed here would be quite costly, not only in terms of dollars but it is very costly in terms of staff time to do the kind of program that they're requiring, and I think particularly when we already have a fair amount of reviews.

I would be interested in putting together some system which involves greater participation of the SBDC directors in reviews that we are currently doing. I think it would be very valuable to us. I don't see the need to construct a whole new evaluation program for that purpose. I think it is something that can be worked out in our own internal operation.

Mr. DAUB. Mr. Chairman, I yield back.

Mr. NEAL SMITH. Just a couple of questions. Do you, not the district director, sign the agreement?

Ms. ALBERTSON. Yes. That's right. I sign the allocation of funds. The cooperative agreement is signed by our grants management office after my approval.

Mr. NEAL SMITH. So you're the one that has to approve it anyway.

Ms. ALBERTSON. That's right.

Mr. NEAL SMITH. If it hasn't been through the process you think it should have been through, you're not going to approve it.

Ms. ALBERTSON. That's right.

Mr. NEAL SMITH. You're operating by SOP instead of regs. You don't have to go through the administrative procedures and all that. You just operate it with an SOP, so you could change that in an hour, couldn't you.

Ms. ALBERTSON. No. SOP's are hard to change, and I would not——

Mr. NEAL SMITH. Why?

Ms. ALBERTSON. Well, you can amend it, but I would not. I think that my 2 years of management in the program, Mr. Chairman, has shown that I run a kind of consensus operation. I'll discuss it with the SBDC director.

Mr. NEAL SMITH. Well, you say that you're asking him to comment on it now, but you didn't ask him to comment on it before you drafted the SOP.

Ms. ALBERTSON. Yes, I did. They were very heavily involved and participated in the SOP, in putting it together.

Mr. NEAL SMITH. Who was?

Ms. ALBERTSON. The executive committee and then each SBDC director was sent a copy of some procedures, the forerunner of the SOP, and they were asked to comment, and they did; and then at a national meeting of the Small Business Directors Association the SOP was discussed. One whole day was set-aside for discussion of the SOP, and we discussed it both in preliminary session, and we discussed it in regional sessions. We did do some modifications to take account of objections they had, and we did to those, and the association had ample opportunity to discuss and approve and, indeed, they did do so of the SOP.

Mr. NEAL SMITH. Are you saying that they really were in favor of this provision that gives veto to the district director?

Ms. ALBERTSON. They certainly did not object.

Mr. NEAL SMITH. When was that?

Ms. ALBERTSON. It was in March a year ago.

Mr. NEAL SMITH. When did you first start hearing the objections? In other words, when did the problems occur?

Ms. ALBERTSON. Well, we had problems which we attempted to work out in a negotiating kind of way, but I only began to hear of the association's concern about it in the last meeting that I attended.

Mr. NEAL SMITH. When did the first problems really come up?

Ms. ALBERTSON. The major problem, I think, came up about 4 or 5 months ago.

Mr. NEAL SMITH. How did you resolve that?

Ms. ALBERTSON. Got the parties together and sat them down and said work out your problems, and I assumed that they had. They certainly made some progress during the time I was there in discussing the problems.

One of the major issues was whether or not the SBDC was really—would put an offsite campus—off-the-campus location, and that had been the initial prcblem.

Finally, the SBDC director agreed to do that, and then the place selected was not acceptable to the district office so they had another go-around on that.

I have to say this, and I won't go into names if I may leave those out—there are personality problems. There are those who get a fixed way of doing things and, in my view, sometimes the art of negotiation is not one of their strong suits.

Mr. NEAL SMITH. Well, I guess I am a little bit puzzled now because this language we've been talking about applies when you're getting the cooperative agreement approved, but you are talking about a problem that arose after the agreement was approved apparently. Is that right?

Ms. ALBERTSON. It occurred at the time of renewal. These agreements, Mr. Chairman, are negotiated each year.

Mr. NEAL SMITH. Right.

Ms. ALBERTSON. They're only for 1 year, and so it occurred at the time of renewal.

Mr. NEAL SMITH. You negotiated a new agreement?

Ms. ALBERTSON. Yes, sir; that is when it occurred.

Mr. NEAL SMITH. Yes.

Well, you recognize the problem, don't you?

Ms. ALBERTSON. Yes, I do. Yes, I do.

Mr. NEAL SMITH. And if this isn't the way to do it, we need to do something.

Ms. ALBERTSON. Yes, we do, but I don't think we need to legislate it. I think we can work it out in other ways.

Mr. DAUB. Could I ask one more question, Mr. Chairman, with your permission? I won't get a chance to question you again after the next panel.

Will you be staying through that testimony?

Ms. ALBERTSON. Yes, sir.

Mr. DAUB. Will both of you stay? I would like to be able to write a letter to you to elicit from you because I intend to pin them down to illustrate by name, by person, by SBDC where and who and how the problems occurred from their point of view, and then I want your input relative to that for the record. I intend to investigate these personality problems or turf battles or whatever they are going on out there, and I don't care who is at fault—your department or them or whatever—I intend to get to the bottom of it. If you do stay, I would appreciate being able once I get their testimony on the record, to have your side of the story as well.

Ms. ALBERTSON. Certainly.

Mr. DAUB. Thank you, Mr. Chairman.

Mr. NEAL SMITH. Thank you very much.

Mr. THOMSON. Mr. Chairman, thank you.

Mr. NEAL SMITH. The next panel will be Garber, Pricer, Ciccarelli, and Bernier.

Obviously we have your statements and obviously we don't have time to go through them, to read them, and it isn't necessary anyway, but can you, and just in a very brief summary, each one of you, tell us what your problem is?

Ms. Garber?

Ms. GARBER. My name is Susan Garber.

Mr. NEAL SMITH. I want to say first, we're glad to have you. We have got to have input from the people on both sides, otherwise we're not going to get a roundabout view of this thing.

Ms. GARBER. What I hear you saying is that you don't want to hear any statement. You want to address just some of the issues?

Mr. NEAL SMITH. We just don't have time to read the full statement, or we won't have any time for questions for everybody, but go ahead.

Ms. GARBER. OK. Well, I think based on the way we had originally worked up what portion of this we were going to address, I am going to let Dr. Pricer go first, because he really has——

Mr. NEAL SMITH. All right, whoever you want.

Go ahead.

TESTIMONY OF ROBERT W. PRICER, DIRECTOR, SMALL BUSINESS DEVELOPMENT CENTER, UNIVERSITY OF WISCONSIN

Mr. PRICER. Mr. Chairman, members of the committee, I'd like to thank you for the invitation to provide testimony at this very important hearing.

I had intended to open my statement with impact data for the entire program, and when we're through talking about section 4 of H.R. 5334 if you'd like me to go back to that I would be happy to do so.

Before we go into specifics with section 4, I'd like to take this opportunity to point out the tremendous management job Ms. Johnnie Albertson has done at SBA, Ms. Albertson and her staff.

In just 18 months she's brought organization and direction to the SBDC Program, and I think she needs to be recognized for that. My concern, and I think most members of the association share the same concern is that she does not have line authority that is necessary for her position to be successful.

I'd like to illustrate that for you.

Mr. NEAL SMITH. All right. That's good.

Mr. PRICER. As I understand the chain of command that would have to be followed, it would go like this. If Johnnie had a policy that had to be communicated to SBDC directors, step one would be to contact Jim Thomson, the Associate Administrator for Management Assistance. Step two would be for Jim Thomson to contact Jim Sanders, the SBA Administrator.

Step three would be for Jim Sanders, SBA Administrator, to contact the SBA regional administrators.

Step four would be for the SBA regional administrators to contact the SBA district directors.

Step five would be for the SBA district directors to contact the ADMA's, the Assistant District Directors for Management Assistance, who act as project officers.

Now if you think of those steps in the form of a chain, with no direct line authority from the associate administrator for SBDC to the program then I think you can begin to see some of the problems that we have. Section 4 maintains the reporting relationship with SBA that existed in the past.

Recent proposed changes by SBA in the program announcement, and it is important to note that this is part of our cooperative

agreement language and in the policy manual and would have the effect of making this a one-way channel, downward only because it gives the district director veto power.

We don't oppose decentralization. We think that we need to work and plan and implement programs with the district offices. I believe that SBA genuinely is attempting to get the district directors and SBDC directors to work cooperatively together.

I think the intentions are just fine. I think though that they have just reversed the process from what it should be. It violated a principal of management to begin with, and that is that you cannot delegate total responsibility.

I feel that Johnnie's office should have full authority and responsibility for the program, and then through policy she can assure that the district directors and the SBDC directors work together to the extent that is best for the program. Without that I feel certain that we're going to have a fragmented program that will reflect more of the personalities of the district directors than that of the State partners or of the national program as it was envisioned.

I would be happy to give you some examples if that would help.

[Mr. Pricer's prepared statement follows:]

Prepared Statement of Robert W. Pricer, Director, Small Business Development Center, University of Wisconsin

Mr. Chairman, Members of the Committee, thank you for your invitation to provide testimony at this important hearing. As you are aware, the United States is just beginning to realize that solutions to many of its persistent economic problems might lie in the small--not big--sector of the economy.

Yet despite small business's disproportionately large contribution to the American GNP, innovation, and employment, small business is in a precarious state.

Studies by Dun & Bradstreet and the U.S. Small Business Administration have shown clearly that the main cause of business failure is lack of management skill. Recently the business failure rate reached that of 1933, the height of the Great Depression. Without increased levels of management assistance to smaller businesses, unnecessary failure will continue with tragic results for our economy and untold individuals.

Small Business Development Centers, a growing, university-based national program, are perfectly positioned to provide this service if the Small Business Act is amended to allow them to do so.

In its four years of operation, the University of Wisconsin SBDC, for example, has counseled over 8,000 clients and provided seminars and workshops for over 36,000 others. Virtually every topic in management has been covered. But the range of problems addressed can be better

appreciated by taking a look at some actual cases.

- Voeller, Inc. of Port Washington sent Vice President Joe Voeller and Sales Manager Jack Nordengren on the SBDC's Scandinavian export tour. Voeller had already sold in other countries. But they typically responded to orders instead of aggressively pursuing foreign markets. The trip led to a successful bid to sell a major piece of glass-making equipment in Denmark. Similar arrangements are now being examined in Japan.

- Mark Simonson developed a weight training program at St. Olaf College. His brother, Roy, a hockey and soccer coach, was a skilled designer of custom-design bicycles, fiber glass masks for hockey goalies, and weight-lifting equipment. But their new business, Eagle Custom Athletic Equipment Corporation, was floundering until they came to the SBDC. The Simonsons simply lacked business training. The SBDC helped them develop a business plan, a loan package, and a marketing plan. Employment and sales increased, and Eagle's new national reputation was capped by being chosen the equipment supplier for the National Powerlifting Championship televised on NBC Sportsworld.

- Vortron, Inc. of Beloit had been a family-owned manufacturer of smoke houses since 1969. But Vortron began experiencing sharp drops in profit even though sales were increasing. The SBDC determined that the firm's management had no sales and manufacturing orientation, paying little attention to cost controls, pricing, or financial analysis. SBDC helped Vortron set up a cost-control system and inventory-valuation policies, and discussed buy vs. lease options as alternative cost-sharing measures.

In one year following SBDC assistance Vortron's sales went from +36% to +104%; profits from -431% to + 1553%; and net worth from -1653% to +221%.

SBDC counseling has saved scores of potential business disasters from ever going into business; has started scores of entrepreneurs off on the right foot; and has helped refine and strengthen the practices of many more established businesses.

Here is our national economic dilemma:

- Unemployment has hovered between 6% and 7% even in the past few years of boom and surpassed 10% during the past recession. At the same time, we have learned that Small business is the prime job-creating force in the economy. As David Birch of M.I.T. has observed "about 60% of all jobs in the U.S. are generated by firms with 20 or fewer employees and about 50% created by independent, small entrepreneurs" so that "any economic development policy aimed at stimulating job growth must come to grips with this reality."

- Innovation has been lagging in the United States while evidence has been mounting that small business is the most effective source of innovation in the economy.

- The rate of American productivity improvement has declined to near zero while studies are suggesting that small business productivity is higher than that of big business. Business Week has put it succinctly: "Our loss of competitiveness over the past two years has been nothing short of an economic disaster;" and "unless there is a radical change in U.S. productivity, Germany and Japan will overtake us in the mid 80"s." Small business is the key to competition and, thus, increasing productivity.

- There is a growing awareness of the huge disparity between the management skills of big and small business - and that the country pays a heavy price (estimated at $4 billion annually) for the nearly 15% per year bankruptcy rate of small business. Yet it is a demonstrated fact that the trained and counseled small business person fails less.
Half of all new small businesses fail each year. But the failure rate of firms counseled by the SBDC is only one-tenth as high.

- America's balance of payments advantage of a few years ago has steadily eroded; and today we are in a serious deficit position. As Business Week puts it, "no other area of U.S. economic life has been so neglected and deprived in Government as that of exports." Meanwhile, we have discovered some 3,5000 Wisconsin small businesses who could be--but aren't--exporting.

- There is a growing concern among a wide spectrum of citizens about increasing concentration in the American economy. The innovative, dynamic smaller firms are being "crowded out" by country-sized public and private bureaucracies. Milton D. Stewart, President of the Small Business High Technology Institute and editor of Inc., has shown us that "small business will have to produce some $900-billion more than it will produce in 1990 if the 1963-72 trends continue."

- Perhaps most important, we are just beginning to realize that small business is where the great majority of jobs are created in this country. A recent study by the Bureau of Business Research at the University of Wisconsin-Madison School of Business is revealing. From 1973 to 1978, the study shows, larger manufacturers in Wisconsin cut 9,300 jobs;

smaller manufacturers, meanwhile, were creating 46,000 jobs. Small business was especially hard hit by the most recent cycle of recession. The destructive impact of small business failure is felt not only by individual owners and managers, but by thousands of persons whose jobs depend on small business. When a small business fails, existing jobs are lost and the potential for additional job creation is forfeited.

All this explains why in 1980 the Congress of the United States established the program of Small Business Development Centers to provide management assistance, education, and research to the small business community.

However, the U.S. Small Business Administration has, until recently, had difficulty providing the leadership and management needed to assure the uniform growth and efficient and effective operation of the SBDC program. Credit must be given to Ms. Johnnie Albertson, Deputy Associate Administrator for Management Assistance, who has brought SBA oversight of the SBDC program under control and is doing an outstanding job. I am concerned that Ms. Albertson will not have the authority needed to adequately manage the SBDC program, however.

For example, SBA has delegated total agency management authority for the SBDC program to their District Directors. This approach probably is well suited for traditional "in-house" SBA programs that have a long history and are well understood by SBA personnel.

In the case of the SBDC program, decentralization has created problems and the tendency for widely varying interpretations of SBDC policy by District Directors. This process will invariably lead to a fragmented program reflecting the individual personalities of District Directors instead of conforming with

the intent of Congress or the desires of the state participating in the program. The problems created by decentralization can be better appreciated by looking at some actual cases.

- In Utah, the SBA District Director initially mandated that the SBDC move into a downtown "storefront" location in Salt Lake City. SBA was insistent upon this even though the greatest need for service was some miles away in an area of business expansion and small business development. In addition, SBA unilaterally determined that the SBDC would provide, at no cost, office space and support for the local SCORE Chapter in the new "storefront" location.

- In Wisconsin, the SBA District Director has been inconsistent in the scope of service he wants provided by the SBDC. In the past, short-term counseling (15 to 45 minutes in length) was required to "maximize market penetration." Last year the emphasis shifted to in-depth counseling (12 hours or more) and recently the District Office suggested that we shift, once again, to place emphasis on "pre-venture" services. This constant change makes it extremely difficult to develop a consistent program that is responsive to actual small business needs.

- In Connecticut, the SBA District Office reversed the ratio of in-depth to short term clients making it virtually impossible for this program to reach established performance levels. Even when this error was pointed out to the SBA District Office, key SBA personnel refused to recognize that they had made a mistake and this resulted in a difficult environment for the development of a new SBDC program. Partly as a result of the District Office action, the Connecticut SBDC program has not reached its potential and is still trying to find a direction that will lead to stable operation and growth.

These examples are representative of the many inconsistencies and difficulties created by SBA decentralization of the management of the SBDC program. In every region of our country additional situations could be cited that underscore the problems created by decentralization.

I believe this situation exists because SBA genuinely wants the District Director to become actively involved with, and supportive of, the SBDC program. To accomplish this, SBA has delegated responsibility and full authority for agency management of the SBDC program to the District Director with the Central Office staff providing "policy" statements to provide uniformity to the program. However, the Central Office staff does not have a line relationship with the SBA field staff and is, as a result, unable to enforce specific uniform application of policy.

In my opinion, the process is the reverse of what it should be for the efficient and effective management of the SBDC program. That is, SBA Central Office should retain full responsibility and authority for SBDC program management and, as a matter of policy, require the SBDC to work with the SBA District Office in program planning and delivery.

For this reason, it is recommended that the Small Business Act be amended to require centralized SBA management of the SBDC program. This recommendation is supported by the Bentley Clark Associates evaluation of the program and the stated position of the Association of Small Business Development Centers.

On a related matter, SBA has recently changed guidelines to allow for more than one SBDC in each state. This appears to illustrate a lack of understanding

of how an SBDC should function. A primary role of an SBDC is to act as an "umbrella" organization for the identification and coordinated delivery of private, state, and federal resources and programs to assist small businesses.

It is recommended that the Small Business Act be amended to allow for only one SBDC in each state to assure that programs and services are delivered in a coordinated, efficient and effective manner.

As an individual deeply concerned about the quality of developing SBDC programs, I would like to take this opportunity to suggest that your committee require a "peer" review and evaluation system for the SBDC program. As you are probably aware, the Association of Small Business Development Centers has developed a comprehensive set of standards that would be useful in this process.

Given the proposed sunset date for the SBDC legislation, it is essential that a meaningful set of standards be applied to each SBDC and this can best be done through a "peer" evaluation process. SBA, of course, should be a part of the evaluation process and I am certain that it would lead to a strengthened program.

In Wisconsin, the SBDC "market" is 100,000 existing small businesses and untold thousands of prospective entrepreneurs. Already we are providing counseling for 3,000 clients per year, and training for nearly 15,000 individuals. Still, we annually must turn down 3,000 requests for assistance.

A statewide network of educational institutions, jointly funded by Federal and State dollars, offers the most cost-effective means of providing quality

training and, particularly, long-term counseling to the small business client. By no other means can we as rapidly, as cheaply, as effectively be in place with training and counseling where most small business clients reside.

By no other means can we mobilize so much legal, technical and professional small business help for small business clients in so short a time. By no other means can we offer small business people "big business-like" help at so small a cost. Linking university skills and resources to small business clients can produce results which are in the national interest.

The future need for SBDC services will, of necessity, expand well beyond those services currently being provided. The United States is experiencing a major and irrevocable structural change in its economy. We are entering an era of high technology--personal computers, robotics, and telecommunications. Changes will be rapid and continual. Small business will need to understand and adjust to these changes.

Similarly, the United States will move away from labor-intensive, production-oriented industries to the provision of services and information. We are becoming a nation that will prosper on managing, communicating, planning, organizing, and coordinating skills within a high-technology environment. These skills in turn will create new businesses, new technologies, and new ways of doing business. Small Business will need to develop and adapt these skills in order to survive and flourish.

The importance of small business to the national economy will continue to grow. However, structural changes and the need to develop and employ new skills

will require an expanded role for SBDC's and their linkages to both universities and vocational/training schools.

There is a growing consensus in this country that it's time to ge back to work--to re-industrialize, to innovate, to increase productivity, to export. Small businesses can play a major role in this exciting future if they develop and expand the skills needed to cope with change. The Small Business Development Center has a major role to play in helping these firms stay competitive and you are urged to enact the recommended changes to the Small Business Act presented in this testimony.

Mr. NEAL SMITH. We'll move on. We may come back to them and ask for them.

Mr. DAUB. I read your testimony.

Mr. PRICER. Fine.

TESTIMONY OF SUSAN M. GARBER, DIRECTOR, PENNSYLVANIA SMALL BUSINESS DEVELOPMENT CENTER, AND PRESIDENT, ASSOCIATION OF SMALL BUSINESS DEVELOPMENT CENTERS, ACCOMPANIED BY ALLEN NEECE, WASHINGTON COUNSEL

Ms. GARBER. I would like to speak firstly to this particular issue before we go into anything else.

I am here in the capacity of president of the Association of Small Business Development Centers, and I served as vice president last year. I have been president since September.

I have to say up front that I agree with some of what Johnnie Albertson has said, in that the association did have an active role in both development of the policy manual and in the part of the SOP that directly affects negotiation.

We didn't deal with all parts of the SOP but we did, as an association, and as an executive committee, work with the proposal process which deals with our relationship on the district level, and I agree with what Dr. Pricer said—at that time and at this time I still support the concept of decentralization on a policy basis.

What's happened and the fact that we did work with it doesn't speak to what has happened in the interim, and in the interim there have been some very severe problems, and these problems have led us to come to—you know, to this juncture and say well, what are we doing now. We have said that, in fact, we do want the cooperation of the local level.

We do want the cooperation from the district offices. Not having that was a severe handicap in our startup stages, but we seem to have gone in the other direction a bit too far, and what we have now is a situation that is open to basically a veto power over how the program is run, and when it comes down to negotiating a contract, and although Pennsylvania has not had particularly severe problems in that area, we have had some, we end up with almost a standoff situation.

I think one of the Congressmen asked about an appeal process. There really isn't an appeal process. There's a review process that comes back to central office. There really isn't an appeal process so there are States in which the resolution really never occurs.

We did talk with Johnnie about 2 weeks ago and talked about having a major meeting and a policy planning rewrite session before we go into a policy manual, but our concern is that some of the problems have been around a lot longer than that, and they have been discussed on an ongoing basis for probably well over a year.

It is crucial to the program survival that we have the ability to work with our local district offices, and also with our local States and with our universities and our private sector partners.

Having one of those partners—the district office of the SBA, having undue influence in that process seems unconscionable, creates a problem, an ongoing problem for us.

[Ms. Garber's prepared statement follows:]

PREPARED STATEMENT OF SUSAN M. GARBER, DIRECTOR, PENNSYLVANIA SMALL BUSINESS DEVELOPMENT CENTER, AND PRESIDENT, ASSOCIATION OF SMALL BUSINESS DEVELOPMENT CENTERS

My name is Susan Garber. I am appearing today in my capacity as Director of the Pennsylvania Small Business Development Centers and as President of the Association of Small Business Development Centers (ASBDC). My statement is divided into two parts: First, I am providing for the Record, a brief overview of the Pennsylvania SBDC. Then, I will discuss the current legislative an administrative needs of the national SBDC program.

Before proceeding, I want to thank you, Mr. Chairman, for this opportunity to appear today. I also want to underscore our deep appreciation for the Committee's steadfast support of the program over the last several years. You, Mr. Smith, and Mr. McDade, the other Members of the Committee and your respective staffs, particularly the Committee's General Counsel, Tom Powers, have been a genuine bastion of strength for all of us involved in the program.

The Pennsylvania Small Business Development Centers Program Overview

The Pennsylvania Small Business Development Center program is comprised of thirteen Centers located in colleges and universities around the Commonwealth. The participating institutions are Bucknell University, Clarion University, Duquesne University, Gannon University, LaSalle College, Lehigh University, Pennsylvania State University, St. Francis College, Temple University, University of Pennsylvania, University of Pittsburgh, University of Scranton, and Wilkes College. Funding of the Centers, as well as supervision of their activities, is coordinated by a state director whose office is located within the Entrepreneurial Center of the Wharton School at the University of Pennsylvania. The thirteen Centers and their fifty-two outreach offices form a statewide resource system available to the 200,000 small businesses operating throughout the Commonwealth. The statewide distribution of the SBDCs enables each Center to focus on a specific region and to tailor its program delivery to the needs and interests of the area that it serves. The overall effect of such an articulated system is a program that truly reflects the diverse character of Pennsylvania's small business community.

PROGRAM DELIVERY

The PASBDC is organized to provide the following support services to the small business community:

Counseling and training

Studies have shown that small businesses are particularly vulnerable in the first five years of life and that failure comes most often from a lack of capital and an absence of sound management and planning practices. The PASBDC program provides free management assistance and low-cost educational seminars for the small

business owner in an effort to mitigate some of the circumstances that threaten small business survival.

Research

In order to provide a useful service to the business community, the PASBDC must constantly update its information and perform primary research. Most research, undertaken in an effort to improve service quality or to answer specific client needs, falls within three basic categories:

Client-based research—market and demographic surveys, impact studies, resource guides and information handbooks.

Community-based research—economic development and neighborhood revitalization feasibility studies.

General data-base development—bibliographies of available publications and resources, economic trends and projections, and analyses of business activity in service areas.

Research results are exchanged between Centers and with other interested agencies, thus helping to reduce wasteful duplication and to generate new applications of original research.

Information transfer

Every SBDC maintains a library with publications covering a wide-range of business topics and information on services provided by other agencies. The SBDCs can be used to access small business services offered by the private sector, and by local, state, and federal governments.

In 1982, the PASBDC provided one-on-one management counseling to 2,852 small business owners. In 1983, this figure increased to 3,700. In 1982, the PASBDC system organized 105 educational workshops which attracted more than 3,600 small business owners. In 1983, they offered training sessions that drew more than 5,900 attendees. Altogether, since the inception of the program in 1979, the PASBDC has served more than 22,500 small business clients in a counseling and training capacity.

PROGRAM ASSESSMENT

Although these statistics show an increasing involvement by the Centers with small business in Pennsylvania, it is important to look beyond the numbers to gain a better understanding of their contribution to economic development within the State. Two studies were undertaken to facilitate an overall program review. The first study was a survey conducted by the Centers of clients served between October, 1979 and December, 1982. The survey revealed the following information:

Approximately 8,750 new jobs were created by PASBDC clients during the period 9/1/79—12/31/82. Using the Chase Econometric Model for the Commonwealth of Pennsylvania, it is estimated that 5,700 secondary or spin-off jobs were created as a result of job growth among SBDC clients.

An estimated 14,500 new jobs were opened up in the Commonwealth as a direct or indirect result of SBDC client growth subsequent to counseling.

Forty-six percent of the survey respondents experienced a profit increase after counseling by the Centers.

Forty-four percent saw an increase in sales.

Eighty-one percent of the respondents stated that they believed their relationship with the Centers was a valuable asset to their business.

Eighty-two percent indicated they would recommend the service to others.

The Governor's Office of Policy and Planning conducted an independent survey of SBDC clients in 1981 which revealed that program services were considered "of quality and worthwhile," particularly in the areas of market analysis, business planning and advertising. These findings are corroborated by the PASBDC survey which noted that over half of the clients needed assistance in these areas, while over a third required help with loan proposals, budgeting, cash flow, and financing.

PASBDC NETWORK

The PASBDC is able to provide a full range of business-related services because of the comprehensive network that links it with community and government agencies, universities, and the private sector. The network, comprising a broad range of resources, enables the SBDC system to respond quickly, creatively and economically to the needs of the local business community and to the individual small business owner. The major partners in this network are the U.S. Small Business Administra-

tion, the Pennsylvania Department of Commerce and the many individuals and institutions that make up the private sector.

The SBA provides the PASBDC with fifty percent of its funding as well as substantial program support in the form of informational materials and shared resources. In return, the PASBDC acts as a door to the small business community, channeling information and providing feedback to the SBA on government programs and services and helping small business clients to understand and take advantage of the new laws that affect them.

The Commonwealth of Pennsylvania also provides substantial funding for the SBDC program. As the State's recognition of small business has increased over the last few years, so has its commitment to the PASBDC. The 1984 appropriation for the program represented almost a three-fold increase over previous years, from $100,000 to $270,000. It is clear from this tangible demonstration of state support that the PASBDC will play an increasingly integral part in Pennsylvania's small business initiatives. James O. Pickard, in his testimony before Senator Weicker's Subcommittee on Small Business, described the State's view of the SBDC function:

"It is because of small businesses' ability to generate new job opportunities, as well as their vulnerability in their early stages of development, that Pennsylvania has included helping them to start-up and grow as a major part of our overall economic development strategy. The Small Business Development Centers with their programs of technical and managerial assistance play a key role in assisting the Department in carrying out its strategy."

In recent years, the PASBDC has cooperated with the Department of Commerce in co-sponsoring a number of statewide conferences for small business. These conferences have dealt with the issues of procurement, small business innovation research, women entrepreneurs and business opportunities in 1984. In each case, the PASBDC has followed up the conference by offering supplemental information and seminars at the local level.

The State has recently undertaken an initiative to bring new technology to the marketplace through encouraging the growth of technology-based businesses. This initiative, known as the Ben Franklin Partnership Program, utilizes the resources of the universities and the private sector to establish four regional Advanced Technology Centers (ATCs). In cooperation with the Technology Centers, the PASBDC's major function will be to provide entrepreneurial development: linking inventors and entrepreneurs with venture capitalists and other financing sources, and providing management assistance to new or expanding technology-based businesses.

In response to the specialized nature of the assistance that technology-based business require, the PASBDC has also embarked on a special initiative to assist this sector of the small business community. In a joint effort with the SBA's Office of Private Sector Initiative and the Northeast Tier Advanced Technology Center sponsored by Lehigh University, the PASBDC is developing a computer-based inventory of available technology-related resources and information within the State. This inventory will form the nucleus of an entire management information system which will enable small advanced technology businesses to identify such things as: venture capital sources; new site locations; names of suppliers and buyers; and procurement and export opportunities.

The management information system will be incorporated into the SBDC's existing services and a one-stop, total assistance program will then be available to small technology-based businesses around the state at their nearest SBDC location.

In addition to the excellent relationship that it enjoys with the Pennsylvania Department of Commerce, the PASBDC interfaces with numerous other state offices involved with small business development. The PASBDC has proven itself to be an adaptable and responsive program which the State has been able to call upon in many different capacities.

Another very important partner in the SBDC network are the universities and colleges. Not only do they house and support the individual Centers, but they provide a stimulating environment that encourages the cross-fertilization of ideas, resources and talents. The university-based Centers enjoy privileged access to a wide variety of expertise and information which, in turn, enables them to provide the kind of comprehensive state-of-the-art management assistance that has become the SBDC trademark.

A number of innovative programs have developed as a result of the SBDCs' unique opportunity to link with other university resources:

SBDC/Law School—Small Business Legal Counseling Clinics have been established by two SBDCs. Utilizing third year law students under faculty supervision, the clinics offer free legal advice in non-litigious areas to small business clients. This program was highlighted by Chief Justice Warren Burger in his Year-End

Report To The Judiciary as being "an innovative cooperative effort" that benefits both small business community and the university law students.

SBDC/Engineering School—Instruction and assistance in computer-aided design and manufacturing (CAD/CAM) is available to SBDC clients in cooperation with the engineering schools of two universities. In addition, another SBDC has arranged for graduate engineering students to assist its clients with feasibility testing and product development in the high technology area.

SBDC/Business School—Most of the SBDCs are located in their university's business school. This location allows them easy access to the resources and expertise within the various departments of the school. In particular, the SBDC utilizes business faculty and students to provide management assistance and to perform client-related research on behalf of the Center. In addition, the SBDC presence within the school provides business students with a first-hand opportunity to counsel small business owners and to observe the actual management process. In this way, the SBDC helps to develop a cadre of experienced young people educated in the values of private enterprise and entrepreneurship.

The fourth and most diverse element of the SBDC network is the private sector, encompassing a broad cross-section of individuals and organizations committed to private enterprise development. Private sector contributions to the SBDC are made on two-fronts:

Financial—Local businesses, institutions, and corporations provide the major secondary source of SBDC program funding.

Professional—The private sector engages in a regular interchange with the SBDC, providing seminar speakers, business data and market information, and specialized counseling.

The close-working relationship between the PASBDC and the private sector augments the capabilities of each and assures delivery of a full-range of services to the small business client. Private agencies and programs working closely with the PASBDC include: economic and community development authorities; trade and business associations; manufacturing and industrial councils; and chambers of commerce.

Private sector involvement with the SBDC is an essential ingredient to the program's success. Not only are they used in a counseling and training capacity, but each SBDC maintains an Advisory Board made up primarily of private sector individuals who help guide the Center's own program development and ensure that it remains closely aligned to the needs of the business community. In turn, the SBDC is able to expand the potential market for private sector consultants and services by sensitizing their small business clients to the need for seeking expert advice and input when making management decisions.

By encouraging private sector involvement and valuing each individual's contribution, the SBDC network has forged a strong and constantly expending base of support within the business community that it serves. As the program enters its fifth year, it continues to serve as a practical illustration of public/private sector cooperation and as a model for professional/academic partnership.

As I mentioned earlier in my testimony, the fact that the SBDC program has been, to date, primarily university based has provided access to a very large resource base. The original SBDC concept depended upon a leveraging of these resources to provide the best possible, most cost-effective delivery of management assistance services.

Public Law 96–302 requires each SBDC to provide matching funds derived exclusively from non-federal sources, in an amount equal to the federal award. The non-federal match has been comprised of financial support from the states, participating institutions, local grants, and the private sector. This financial support has provided increased operating funds for the SBDCs, while at the same time demonstrated the commitment of the contributing partners to the SBDC. In many cases, the educational institutions which sponsor the SBDC provide direct matching funds to the program by the payment of salaries. University personnel who work for the SBDCs by performing one-on-one consulting, training of small business clients, related research activities or feasibility studies, or who provide services necessary to the supervision, administration or general objectives of the program are paid directly by the institution. These people work under the direction of the full-time SBDC director and both the time they have spent in the performance of their tasks and the results of their work is fully auditable.

It is crucial to the continued effectiveness of the overall SBDC program that university personnel be permitted, and encouraged, to participate in the delivery of service. The expertise and state-of-the-art knowledge which they bring to the small business client would be unavailable through any other vehicle. The educational in-

stitution incurs a very real cost in salary and wages which is, and should rightfully be, considered a part of the non-federal match to the program.

Before I leave this issue, I would like to point out to the Committee once again that the success of the SBDC program lies in its ability to leverage resources. Many of the SBDCs, although they are managed by a full-time director and a skeletal staff, rely heavily on part-time employees. These part-time consultants, educators, and researchers come from the private sector as well as from the educational institutions, and bring with them an invaluable arsenal of experience. They are normally extraordinarily knowledgeable, highly respected members of their profession whether it be accounting, legal, engineering, etc., who work for the SBDC part-time thus providing a special level of expertise that would not be afforded on a full-time basis. The use of these resources enables an SBDC to provide a client with a combination of expertise from several disciplines rather than relying solely on business generalists. Certainly in today's business environment which is characterized by constantly changing financial requirements, technological changes, and legal parameters, the SBDCs cannot afford to be constrained by an entirely full-time staff with limited breadth when, in fact, it has available so many additional resources.

Mr. Chairman, we are fully supportive of the funding authorization language in the Committee's working draft. We firmly believe it is necessary that the legitimate expenses of the National Advisory Council be paid by the federal government. It is only reasonable and fair that private sector advisors, who are expected to donate their valuable time and considerable talents to the program be reimbursed for their expenses. In so doing, you are ultimately helping to insure an active Advisory Council such as was envisioned when the SBDC enabling legislation was enacted into law and thus strengthening the program.

Likewise, we support authorizing funds to pay for contracting for a data base and for reimbursing centers for participation in biannual evaluations of each SBDC. Authorizing these funds will, again, serve to strengthen the SBDC program nationally. We view authorizing these funds as a constructive, prudent use of taxpayer dollars.

TESTIMONY OF JOHN F. CICCARELLI, DIRECTOR, MASSACHUSETTS SMALL BUSINESS DEVELOPMENT CENTER, SCHOOL OF MANAGEMENT, UNIVERSITY OF MASSACHUSETTS AT AMHERST

Mr. CICCARELLI. Mr. Chairman, for the record, my name is John Ciccarelli, and I am the State director of the Massachusetts SBDC and since last September vice president of the Association for Small Business Development Centers.

I would just like to address my remarks today, and I'll keep them very brief, to two sections in the bill. One is section 6 and section 7 which there has been some discussion about.

First, is the establishment of the biannual review system of the SBDC's which would be conducted jointly by the administration and the SBDC's.

We commend the committee for establishing the guidelines. The ASBDC knows that the program is only as strong as its weakest program, thus for the past year our committee on standards and evaluation has accepted the challenge of creating a process to thoroughly evaluate an SBDC.

The association, in turn, as part of its mandate has encouraged and facilitated the exchange of programs and operations procedures amongst the SBDC's to ensure that the strongest program is going to be created in the States coming on.

The biannual review process, and I think a process that is made up of a team of SBDC directors, university officials and/or private sector advisory board members and the administration, I think, clearly will get to the heart of some of the problems that lurk out there. I think the review processes that are now in place do not get to the heart of the problems. The problems may be philosophical, may be a lack of commitment. Yes, on paper it all looks fine.

They're meeting all the guidelines, but it goes beyond that, and we believe that such a review system will help weed out those types of problems and get some corrective measures because we want this program to be second to none in terms of its ability to deliver quality indepth management assistance to small business.

I believe we should continue to pursue that type of review system to ensure that this program is strong in every State, and meets a set of criteria that are reasonable but are effective in getting to the key issues and the key points.

Second, with regard to section 7, throughout this oversight process the ability to obtain factual historical data in a timely fashion, I think, has assisted immensely in analyzing the SBDC's.

In addition, the CQQI system plays a valuable role as a management tool to SBDC State directors and SBA State and regional directors in terms of evaluating what is happening at the local level.

We do support the agency's focus right now in having one clear MIS system, so that all programs do report through it. However, at this particular juncture I think there are several critical issues that need to be looked at.

First new SBDC's are coming on without a means to track program performance at this particular point in time.

These SBDC's are basically not in the CQQI system, not in new management assistance MIS system unless they're doing it on their own, and I think this compromises standardization very greatly.

Second, and I think at our meeting in February with SBA, they've admitted, and I think in talking with other computer analysts that problems are going to exist in trying to implement a program of this magnitude in such a short period of time.

I think third from what I have seen this new system is tracking less functions than the CQQI system, and I think that concerns us greatly because as an effective management tool this program has helped all of us immensely, do a better job, so I strongly support the SBDC program and MIS system staying with a private contractor until such time as the management assistance MIS program is up and running and that a transition period that is reasonable and effective can be worked out.

[Mr. Ciccarelli's prepared statement follows:]

PREPARED STATEMENT OF JOHN F. CICCARELLI, DIRECTOR, MASSACHUSETTS SMALL BUSINESS DEVELOPMENT CENTER, SCHOOL OF MANAGEMENT, UNIVERSITY OF MASSACHUSETTS AT AMHERST

Mr. Chairman for the record I am John Ciccarelli, State Director of the Massachusetts Small Business Development Center and Vice President of the Association of Small Business Development Centers.

I wish to focus my remarks today on two key proposals in the Legislation to repeal the Sunset Provision in P.L. 96-302. These proposals are the four year extension of the sunset provision and the funding formula which is presently based on a pro-rated share of a $65 million program based upon population.

First, the four year sunset provision. The SBDCs have welcomed the oversight process which has been conducted since October 1982 with the two SBA commissioned studies, the impact survey conducted by the SBDC under the direction of Dean William Flewellen of Georgia and the Senate and House hearing. I believe the SBDC program has demonstrated its merit nationally and have enacted very effectively the mandate of Congress in providing high quality management assistance and educational offerings to small business. With the program nationally well on its way to being in all 50 states, presently 31 states have funded the SBDC, the Congressional intent to insure it is effectively meeting its mandate to small businesses is appropriate. A Sunset Provision, however, does pose problems in terms of commitment by external funding sources, and attracting quality long-term employee. However, if the intent of Congress is to use this provision as a monitoring vehicle we, the SBDC, welcome it, in addition, however, we wish to support Section 6 and Section 7 to strengthen the process.

FIRST - The establishment of an on-site bi-annual review system of SBDC which will be conducted jointly by the Administration and SBDCs. We commend the committee for establishing the guidelines for such a review. The ASBDC knows that this program is only as strong as its weakest program, thus for the past year the ASBDC's Committee on Standards and Evaluation has accepted the challenge of creating a process to thoroughly evaluate an SBDC. The Association, as part of its mandate, has encouraged and facilitated the exchange of programs, operation procedures, etc. amongst SBDCs. In addition, we commend the Administration for their encouraging new centers to visit established SBDCs to view first hand the operation of an SBDC.

The Association firmly believes that if the bi-annual review process can be conducted with teams made up of the Administration personnel, SBDC directors, university officials and/or private sector advisory board members, such a peer review will be thorough and effective to insure that weak programs can be strengthened, strong programs can be made even stronger, and programs which are not meeting the established standards will be reorganized or eliminated. The Association is committed to making the program second to none in its ability to deliver quality services to small business.

Additionally, we support Section 7 to allow the SBDC Management Information System to remain with a private contractor through October 1, 1986.

Throughout this oversight process the ability to obtain factual historical data in a timely fashion has assisted immensely in analyzing the SBDCs. In addition, a valuable management tool now exists under the present Cost Quality Quantitative Input System or CQQI which allows program managers to readily evaluate performance and coordinate activities.

This CQQI System was supported by the Agency under the then Associate Administrator for Management Assistance, Philip Sprague, precisely for the oversight function and it has proved valuable in its standardized approach to data collection. However, we are now presented with a situation where this private contract is being terminated on September 29 of this year and we will come under a new Administration MIS System. We appreciate the Agency's effort to have all management assistance programs on the same system, but several critical issues await us which will case severe problems.

A. New SBDCs are being established without a means to track program performance, unless developed on their own, thus compromising standardization.

B. The Agency has admitted that come October 1, and it is common knowledge when speaking to computer analysts, that severe problems will result by trying to implement a system of this magnitude in a short period of time.

C. From first indication, the system is tracking less functions then that of the CQQI system which concerns us greatly.

Thus, we endorse the provision in Section 7 to allow the SBDCs to remain with a private contractor until such time as the Administration has implemented fully its management assistance MIS system and a study is completed to insure that at a minimum the system proposed is as effective if not more indepth than the system now in place for the SBDCs.

The second point I would like to address is the funding formula. The present legislation provices that no recipient of funds shall receive a grant which would exceed its pro-rate share of a $65 million program based upon the population to be served by an SBDC as compared to the total population of the United States or 200,000 which ever is greater. We wish to ask the committee to review this formula due to the fact that several critical points need to be considered now that the program is entering its seventh year. These critical points are:

1. Several less populated states will be at their cap almost at their inception leaving little room to create the depth of program needed to adequately service their small business constituency.
2. It has become evident that a statewide program especially in states with low business density ratio, i.e. Montana, the Dakotas, Vermont, Maine, Wyoming, will have an extremely difficult time servicing their state with a $200,000 program.
3. The leveraging aspect of the federal funding will be greatly minimized thus effecting adversely other public and private support.

4. If in fact the matching requirement as stated in the house version is accepted, smaller states will not be able to maximize funding with appropriate part-time employees or facilities.

5. Once reaching the cap these smaller programs, as well as large programs, will experience loss in real dollars which will mean cutbacks in services. For example, the state of Maine in FY '84 experienced a loss of $40,000 in real dollars due to the fact that they have reached their cap. In addition, even though Main is a poor state the SBDC has proven to be an effective economic development tool and is on the verge of receiving state support. A key argument was the leveraging aspect of the federal dollars. In subsequent years, under the present formula with federal funds remaining constant, the additional funding will in turn remain constant and continually erode the base thus resulting in limited service offerings. The same scenario will be repeated across the country thus minimizing the effectiveness of an SBDC.

We recommend that this formula be reviewed closely by the committee to fully grasp the impact it has on all SBDCs but in particular poor less populated states which in fact, need this form of economic development to help create a better environment for growth.

At a minimum, programs once reaching an effective statewide delivery system should be allowed to maintain that system so as to insure that what is there today is not taken away tomorrow.

I would like to take this opportunity to describe the Massachusetts Small Business Development Center program.

The MSBDC is a consortium of both public and private universities with the University of Massachusetts/Amherst School of Management as the lead institution. Other members of our consortium are Boston College, University of Lowell, Southeastern Massachusetts University, Clark University, Worcester Polytechnic Institute and Roxbury Community College.

The MSBDC has evolved into a regional network of centers with the University of Massachusetts sponsoring the Central Administration Unit, the Western Massachusetts Regional Office, and a statewide Capital Formation Specialty Center. The University of Massachusetts then enters into contracts with the above mentioned institutions to provide SBDC services in their respective regions and specialized statewide services. Thus, the services of the MSBDC are easily accessible to all small businesses of the Commonwealth.

The Massachusetts Small Business Development Center program, since its inception in 1980, has established its program on 2 basic premises. The first is to develop a partnership between federal, state and local governments, the academic community and the private sector.

Secondly, once this partnership has been completed, act as a focal point of resources and services to enhance this partnership's role as a catalyst for small business development, growth and stabilization.

When reviewing P.L. 96-302, it is clear that the congressional intent of this program was just as I have described. I hope that the following description of the Massachusetts SBDC will provide the committee a clear example of how their intentions have been placed into action.

Partnership

It has been clear from the program's inception that its effectiveness and ultimate success would result from the wide variety of resources an SBDC could possess to address the diverse needs of the small business community.

It is also evident that each of the partners possess a number of resources, but no one partner possesses the full range of assistance to address the myriad of situations posed to us by small business.

Thus, this partnership allies the strength of each part into a coordinated effort to insure that whatever the question, there is an answer; and, more importantly, a correct, understandable answer in the language of the small business person.

Now I wish to describe our partners and their contribution to the program.

Both the Federal government, through SBA, and the Commonwealth of Massachusetts, through the Department of Commerce, provide funding to the MSBDC, for which we are grateful. More importantly however, a very cooperative relationship has been developed which provides the MSBDC a variety of federal and state financing programs, procurement programs and expert advice.

Our funding proposal to SBA prior to its submission to Washington is negotiated and approved by our federal and state funding agencies and throughout these negotiations coordination of resources is stressed. In this way, we insure the service of each are complimented thus resulting in an elimination of duplicative efforts. For example, our Fourth Year Proposal stresses the priority attention which SBA borrowers will receive from the MSBDC.

The second partner is the participating academic institutions. I wish to address this partner from the viewpoint of my previous position as Deputy Commissioner of the Small Business Assistance Division of the Commonwealth of Massachusetts. Although I had available to me resources previously mentioned, the resources available from the academic institution clearly upgraded the level of sophistication of assistance and allow a counselor to take a client that necessary extra step to insure results.

Faculty expertise, current research and literature, computer access and expertise, and senior and masters level students to undertake tailor-made research for individual clients, all at the fingertips of an

SBDC, provide a resource that is virtually impossible to obtain from any one source. Providing these resources in a effective manner to small business is a critical commitment of a participating academic institution. That commitment is more than a signed contract but a philosophical commitment that whatever resources are needed to assist a client which the University possesses, these will be brought to bear on the case. In fact, our consortium of schools has made this very important philosophical commitment.

Our third partner is the private sector. The Massachusetts Small Business Development Center has actively courted the support of the private sector for they not only possess business expertise but they have become our link to the small business community to insure that our program is addressing the critical needs in a timely, effective manner.

To insure that this resource is fully developed, the MSBDC has established both statewide and regional advisory councils to insure our program is responsive not only to the state as a whole, but to the unique situation arising within a particular region.

Aside from program development issues, the members of our advisory council play a key role in opening new doors of opportunity, whether they be a trade association, a bank, or a private financing source. They provide us with expertise when facing a client's problem which is beyond our resources. They have, in fact, become an active member of our marketing effort by referring clients to the program. In turn, the MSBDC stress constantly to clients the need for private sector expertise in their businesses.

In addition to the work of our advisory council, other private sector concerns have proved to be an invaluable resource for our educational and training offerings. The enthusiastic response from lawyers, accountants, business owners, bankers and consultants, to conduct a workshop or participate on a panel, in many cases pro bono, has resulted in better than 78% of our training programs involving private sector presentors.

FOCAL POINT OF SERVICE

Now that our partnership has been outlined, there is now the need to coordinate and disseminate these resources to our client. Thus, our second main objective is to act as a focal point of resources for the entrepreneur. In essence, each partner performs this task, however, government and academia perform it on a more macro level while the SBDC and the private sector are performing it a micro level.

The SBDC is performing this very important coordinating function with each and every client it services or attendee at a training session. The SBDC is constantly performing the role of identifying what resources are most appropriate to address the need and then to coordinate and monitor those resources in each individual case to insure appropriate results.

The SBDC is not only performing this function for the small business person but to other small business services providers as well. For example, the MSBDC has worked closely with Community Development Companies, Certified Development Corporations, Chambers of Commerce,

Trade Associations etc. to assist them in servicing their clients or members and to insure that if they do not have the resources they can access those resources.

What is critical is that whether it be a local economic development entity or SBA, whether it be SCORE or a financial institution we are all striving for the same goals and that is a healthy, vibrant small business community, creating jobs, putting people to work to help the economy grow and prosper. By working together as we are doing in Massachusetts, this goal can be achieved.

Briefly, I wish to take the committee through what I believe is an accurate case history of what I have outlined.

The Athol/Orange area of Massachusetts, which is located in the north, central part of our state, is one of approximately six areas experiencing an unemployment rate more than double the state average. This area is characterized by vacant manufacturing facilities; a depressed downtown area and looms under the constant threat of more jobs lost as the mature, more traditional industries in the area reassess their shrinking markets.

In an effort to address the needs of this area and to begin the revitalization process, the Massachusetts Department of Commerce has developed a far reaching economic development plan. The various pieces of this plan include the strengthening of the existing economic base,

an aggressive marketing campaign to attract new industry to the area, better transportation facilities and the development of a strong local commitment to ensure success.

Within the first phase of this plan, the MSBDC has been called upon by the Commerce Department to work with the existing small businesses in an effort to stabilize the erosion of the economic base and begin the process of strengthening it so that it can become the foundation of new economic growth.

The MSBDC has met this challenge by placing the Director of our Western Regional Office in this area every Wednesday since October to work with local officials, the banks, existing small businesses and entrepreneurs with new small business ideas.

Local officials have credited the MSBDC with the stabilization and expansion of at least 12 businesses which, at a minimum, jobs have been retained which would have potentially been lost and, in fact, a modest number of new jobs have been created.

Another MSBDC resource has provided direct assistance to one of the first tenants of the area's new industrial park by working with the client and local officials on a very intricate lease agreement and as late as last week, assisting the client and a local bank in developing a financial package which is close to being consummated. One of the SBA loan programs will likely be a part of this package.

This example clearly shows how our partnership and serving as a focal point for resources, when brought into a situation such as Athol/Orange area, can be one of the most effective tools established in Massachusetts to service small business and economic development.

This is only one of many examples which I could provide.

Results

During the 42 months of our existence, the MSBDC has assisted over 4,300 clients and has provided training programs attracting over 8,500 participants. These figures do not include the hundreds of phone calls which are referred to more appropriate sources or are handled by mailing various literature packages.

The MSBDC has conducted two impact surveys covering 1980 through 1981 and 1981 through 1982. The survey asked those clients who received five or more hours of counseling and whose case had been closed for at least 12 months what impact the MSBDC assistance had on their gross sales, profit and employment. The attached two tables are the results of those surveys (see APPENDIX A and APPENDIX B).

The results of these surveys clearly indicate the very positive effects that an SBDC can have on its small business constituency, the state, and the nation in creating an atmosphere for business development and growth.

There are also many intangible results which many times go unnoticed, such as the identification to a start-up venture that more planning is needed before they embark on their venture to insure success, or assisting in rectifying a management problem which may not produce new jobs but insures a fighting chance for that business to survive.

Mr. Chairman, thank you for the opportunity to address the committee this morning. I appreciate this committee's support of the SBDC program and hope that together we will insure that this program is a catalyst for small business development for years to come.

I will be pleased to answer any questions you may have.

APPENDIX A

IMPACT SURVEY - 1980-1981

TABLE 1

Program Impact on Client Operations

Gross Sales:	87% improved
Profit:	51% improved
Employees:	3[illegible]% improved

TABLE 2

Client % Change in Sales, Employment, Profits[1]

	Average % Change: SBDC Clients Sample (N=55)	Average % Change: All Massachusetts Small Businesses
Sales	+20	
Employment	+12	-.3
Profits	+69	

TABLE 3

Client Incremental and Aggregate Changes in Sales, Employment, Profits

	Average Incremental Absolute Change for SBDC Clients	Average Change for Full Year of Clients (N=169)[2]
Sales:	$104,019	$17,579,211
Employment:	1.5	254
Profit:	5,694	962,286

TABLE 4

Incremental Change in Tax Revenues of Massachusetts

	Average Change	Aggregate Change (N = 169)
Sales Tax (Average Incremental Change in sales x 5%: Sales Tax for most of period in consideration) x 66% firms subject to tax.	3,433	$580,114
Personal Income Tax (Average Incremental Change in Employees x 934)	1,401	$237,236
Corporate Income Tax (Average Incremental Change in Profits x Massachusetts' Effective Corporate Tax Rate: 9.9)	564	$ 95,266

TABLE 5

Impact of SBDC Counseling in Massachusetts on Government Revenues, 1980-81
(Estimated Tax Revenues Generated by Increased Sales, Employment, and Profits)

	Estimated Tax Revenues	Funds Expended by SBDC[3] for Counseling (1980-81)	Ratio: Benefits to Cost
State	$912,616	$ 72,181	12.6:1
Federal[4]	563,372	144,435	3.9:1
Total	$1,475,988	$216,616	6.8:1

1 All figures in the suvey are Net (both positive and negative responses are used).
2 Clients who have received 5 or more SBDC counseling hours
3 Minus 20% which was expended for training purposes
4 Federal = Median income tax ($2218) x employment increase

APPENDIX B

IMPACT SURVEY - 1981-1982

TABLE 1

Program Impact on Client Operations

Gross Sales:	62% improved
Profit:	56% improved
Employees:	35% improved

TABLE 2

Client % Change in Sales, Employment, Profits[1]

	Average % Change: SBDC Clients Sample (N=82)	Average % Change: All Massachusetts Small Businesses
Sales	+11.5	
Employment	+31.3	-2.2
Profits	+119.7	

TABLE 3

Client Incremental and Aggregate Changes in Sales, Employment, Profits

	Average Incremental Absolute Change for SBDC Clients	Average Change for Full Year of Clients (N=732)[2]
Sales:	$71,589	$52,403,148
Employment	2.9	2,123
Profit:	19,420	14,215,440

TABLE 4

Incremental Change in Tax Revenues of Massachusetts

	Average Change	Aggregate Change (N = 732)
Sales Tax (Average Incremental Change in sales x 5%: Sales Tax for most of period in consideration) x 66% firms subject to tax.	2,362	$1,729,304
Personal Income Tax (Average Incremental Change in Employees x 934)	2,709	$1,982,882
Corporate Income Tax (Average Incremental Change in Profits x Massachusetts' Effective Corporate Tax Rate: 9.9%)	1,923	$1.407.329

TABLE 5

Impact of SBDC Counseling in Massachusetts on Government Revenues, 1981-82
(Estimated Tax Revenues Generated by Increased Sales, Employment, and Profits)

	Estimated Tax Revenues	Funds Expended by SBDC for Counseling[3] (1981-82)	Ratio: Benefits to Cost
State	$5,119,515	$165,435	30.9:1
Federal[4]	4,708,814	330,871	14.2:1
Total	$9,828,329	$496,306	19.8:1

1 All figures in the survey are Net (both positive and negative responses are used).
2 Clients who have received 5 or more SBDC counseling hours
3 Minus 20% which was expended for training purposes
4 Federal = Median income tax ($2218) x employment increase

Mr. DAUB. Before the next panelist, are there five or four of you?

Mr. PRICER. Four.

Mr. DAUB. Four, OK. It is a pleasure for me, Mr. Chairman to have Bob Bernier before our committee. Mr. Bernier has served as director of the Nebraska Business Development Center for 5 years. Now he received his MBA from the University of Nebraska at Omaha in banking and finance, and he may be embarrassed about this, but I just want it in the record before he speaks with us today—in 1982 he received two outstanding awards.

One was from the American Assembly of the College School of Business for the programs of his center that were provided for women, and the second was the Levi Award for Excellence in Private Enterprise from the Freedom Foundation at Valley Forge.

The Nebraska Business Development Center was one of eight pilot business development centers to begin with, served 1,050 small businesses and 143 different Nebraska communities. In addition their training programs have helped well over 5,000 people so it is with tremendous respect that I have and pride in the program that he directs, and I welcome and we should welcome Mr. Bernier to the committee today.

Mr. NEAL SMITH. Thank you. Glad to have you.

TESTIMONY OF ROBERT E. BERNIER, DIRECTOR, NEBRASKA SMALL BUSINESS DEVELOPMENT CENTER

Mr. BERNIER. Thank you, Congressman. I've my written testimony to submit to you, and we've spent a lot of time here today talking about some issues which I have some opinions on but I'd be happy to give those in response to questions, but I can't help feeling sitting through here this morning that we're losing perspective on the program, itself.

These are really minor issues. They're issues that need to be clarified and need to be solved, but I am going to focus a little bit on what a small business development center does and the fact that we've been successful in the past 7 years in our programs.

We say our mission is to provide management and technical assistance to small business, and that is no small thing. There are a great many types of small business having different levels of needs of education and resources, and our resources are also limited, and we have been effective in providing good management assistance to small businesses by staying close to the businesses we serve.

In Nebraska we have an advisory council. I sit on the Small Business Council of the Omaha Chamber of Commerce. We meet regularly with chambers of commerce throughout the State and with trade associations, and we keep constant watch for the kind of demands we get from businesses.

For instance 2 years ago we had a lot of demand for help with cash management, and financial forecasting. Business was concerned with survival.

More recently we've had a lot of demand for market research, for business expansion planning. Businesses are concerned with expanding and starting up new enterprises.

We also try to stay close to the needs of our local economies. In Nebraska that means a heavy emphasis on agribusinesses and on

service industries, and not quite so much emphasis on high technology industries as my colleague in Massachusetts might want to focus on.

We meet those needs in Nebraska through a statewide network that does include five academic institutions but also includes more than 40 chambers of commerce and commercial clubs. We are truly a statewide operation and I might note that we served 100 or more businesses in 143 Nebraska communities in 1983.

There was some discussion in the past about what constitutes a good lead school and those kinds of decisions on a local level, and whether it is an academic institution or not, I believe that what constitutes a good lead institution is a deep commitment to public service, and where you have that, I think that you will have good small business development centers.

One of the statements that was not read orally here today but was in the presentation by the SBA that I disagree with is that SBDC's are a high-cost delivery service.

What I would say is that they're a highly effective delivery service. In 1982 our clients paid taxes on additional income and sales attributable to our counselling that resulted in $1.50 of taxes, State and Federal, for every $1 of our funding.

I think that is effectiveness. I think that is good use of our funds. In Nebraska we feel we have a strong record of success in our SBDC.

We have had 7 years to learn from our failures and from our successes, and we believe that there are more recently established SBDC's that are having difficulties, but that as they mature they will improve as well, and supporting that is a genuine interest among SBDC's in helping newer programs along the way.

A new spirit of entrepreneurism has captured America. When the SBDC program was conceived in 1976 there was but a vision of that enterpreneurial spirit. It's now become a reality. We believe that the SBDC is an idea whose time may have been a vision in 1976 but has arrived in 1984.

[Mr. Bernier's prepared statement follows:]

PREPARED STATEMENT OF ROBERT E. BERNIER, DIRECTOR, NEBRASKA SMALL BUSINESS DEVELOPMENT CENTER

Good Morning. Thank you for this opportunity to speak to you today about the Small Business Development Center program.

The Nebraska small business development center is one of the five oldest SBDCs in the country. It was organized in 1977 as one of the eight pilot centers of what was then known as the University Business Development Center program. In that time we have seen a lot of changes in the small business development center program and feel that we have made some contributions to its development.

I have been associated with the Nebraska Business Development Center since its beginning and have been its director the past five years. In that time I have come to develop some personal feelings about what a small business development center is and some beliefs about what a small business development center ought to do. I would like to share some of those thoughts with you today.

MISSION

As a small business development center, we say and we believe that our mission is to provide management and technical assistance to small businesses in Nebraska. Though it is an easy thing to say, it is no small thing to accomplish.

As you know, there are a great many types of small businesses. They have different needs and different desires. They have different levels of experience and education and different levels of resources.

Our resources are also limited. I believe we have a responsibility to use those resources in ways that will improve the economic development of our respective states and of the nation.

That means we necessarily make judgments about the amount of time we spend with clients who have a significant potential for contributing to economic development relative to those clients who do not.

In doing so, we are aware that all of our clients are taxpayers both to the federal and to the state systems which support us. We must, then, make some effort to provide assistance to every business owner who truly wants it.

Balancing these obligations requires an efficient operation and one that responds effectively to the needs of small businesses.

Two years ago, for example, we had a tremendous demand for cash flow analysis, budgeting and financial forecasting. Businesses were concerned with survival.

Today we are experiencing a different demand. It is a demand for market analysis, loan packages, and feasibility studies. Businesses are planning expansions.

At the same time we recognize a responsibility to provide education and guidance to our clients. To caution them, for instance, that financial planning is as important in good financial times as it is in bad.

We are also influenced by the needs of the regional economies in which we operate. In Nebraska, agricultural and agriculturally related businesses are very important. Outside of agriculturally related businesses in Nebraska, the service businesses are far more dominant than manufacturing or new high technology businesses. We feel a responsibility to recognize the dominant role service industries must play in the economic growth of Nebraska and design services to meet their needs.

Part of the strength of the SBDC program is its ability to respond to local needs. In Nebraska, we keep aware of those needs by monitoring the levels of demand for certain types of services; by securing the advice of our advisory boards; by interacting with the small business councils of local chambers of commerce; and through a close working relationship with the SBA's Omaha District Office, the Nebraska Department of Economic Development, SCORE chapters and other organizations.

STRUCTURE

In Nebraska we meet those needs through a state-wide network. We were the first SBDC to implement a state-wide delivery system and we have one that we think works quite well. As evidence of that, I might note that in 1983 we served businesses in 143 Nebraska communities.

Our state-wide network is divided into two parts—consulting and training.

We have five regional service centers providing consulting services. These are located in Chadron, Kearny, Lincoln, Omaha and Wayne. Each is sponsored by a state college or university.

Our training program is coordinated from our lead center in Omaha. Most seminars and workshops are sponsored through more than 40 chambers of commerce, commercial clubs and trade associations in Nebraska. Many are provided through institutions in our state-wide network and through community and technical colleges.

As part of our training program effort, we publish a monthly management brief containing articles on business management practices. This publication is distributed for us principally by chambers of commerce.

In delivering our services, both consulting and training, we use the best available people we can find wherever they are in the state and whether associated with the educational institutions in our consortium, with other educational institutions, with private industry, or with volunteer organizations such as SCORE.

To ensure close cooperation between the Nebraska SBDC and other SBA management assistance services in Nebraska, the officers of the SBDC meet weekly with the Assistant District Director for Management Assistance and two representatives of Nebraska SCORE chapters.

SUPPORT

The Nebraska Business Development Center began when small business development centers were but an infant concept with but eight pilot programs. It began under a contract environment with no requirement for matching funds. Yet, from the beginning we received support from our lead institution through contributed faculty time and overhead waivers.

There has been much discussion about the kind of institutions that make the best host for a small business development center. In my mind, one quality must stand above all others—a deep commitment to public service. We have such and institution in the University of Nebraska at Omaha.

From the start we have had the strong support of the University's administration and its faculty.

The Nebraska Business Development Center operates as a department of the College of Business Administration with its director reporting to the Dean. It has enjoyed the full support of the Dean and of the University's Chancellor.

Responding to that support, the faculty of the College participate fully in the Center's programs. The depth of that commitment might best be illustrated with a story. Several years ago, a clerk in the University's accounting department called me in disbelief regarding an expense account from a faculty member indicating he had travelled 600 miles and charged us for a three a.m. breakfast but no lodging. The faculty member had, I explained, delivered a seminar for us in Broken Bow that evening and had returned in the early hours of the following day so as to teach a class on campus that morning. Accounting clerks call no more regarding such occurrences. They have become common.

As the Nebraska Business Development Center has grown and with the requirement for cost sharing, the University has assisted in financing the center. Our center receives approximately $60,000 in academic budget support through the College of Business Administration. The University of Nebraska-Lincoln contributes a similar amount for the program on its campus.

In addition, the University of Nebraska at Omaha waves all but a small portion of the indirect costs associated with our program. Indirect costs captured by the University are less than six percent of our federal award—a small amount given the support services we receive. The University has provided additional inkind support by providing us an excellent off campus facility in downtown Omaha for which it pays approximately $20,000 annually in rent.

In 1981 the Nebraska Legislature provided additional support to the Nebraska Business Development Center by appropriating $100,000 in improvement funds to the University specifically for our program. That appropriation has grown modestly in the past three years to its current $121,000 level.

The Nebraska Business Development Center has also received support from the University of Nebraska Foundation. This year, for example, NBDC received $25,000 for the purchase of microcomputers.

Increased direct financial support of the Nebraska Business Development Center has been important to its growth. We could not offer the broad range of programs that characterize our center, however, if it were not for the inkind support we get from other sectors of the Nebraska community.

Earlier, I indicated that nearly all of our seminars and courses are provided through chambers of commerce and trade associations. These organizations provide for facilities and promotion of these events. They also distribute to their members the monthly management briefs published by the Nebraska SBDC. These services represent more than $43,000 of inkind contributions to our program in 1983.

Many businesses have assisted our center over these past seven years in sponsoring workshops and seminars, in providing speakers and trainers, and in many other ways.

This past year we experimented with a new form of SCORE support for our program. A member of the Omaha SCORE chapter was teamed with one of our graduate assistant consultants. His years of business experience complemented and supported her academic training. It is a program we expect to expand to all of our graduate assistants this year.

EFFECTIVENESS

I am convinced that the Nebraska SBDC could not have achieved its current level of support from the University, the Nebraska Legislature and the business community without having achieved a solid record of success in its programs.

At the Nebraska Business Development Center we believe that productivity is as important for us as it is for the businesses we serve. And, for us, just as for all successful small businesses, productivity means more than quantity. It means quality as well.

Our quantity is evident in the numbers. In 1983 we served 1,050 small business clients—325 through long term cases and 725 through short term cases. We conducted 122 seminars and courses with 5,257 participants. In July of last year we began our capital formation assistance program with the employment of a business finance

specialist to work with the certified development company in Nebraska on SBA 503 loans and other loan programs. Through the last six months of 1983 we handled 134 inquiries from which nine loans were approved at a total of $2,635,000.

Our quality is evident in the numbers as well. Each year the Nebraska Business Development Center interviews each of the previous year's long-term clients to determine the quality of our program.

In 1983 our 1982 indepth clients were interviewed. More than 80 percent indicated that information they received from our consultants was helpful and 61 percent implemented some or all of the recommendations made. Of those who implemented our recommendations, 71 percent said they were effective.

Most telling to us is the fact that more than 73 percent of those who implemented our recommendations had sales increases while only 27 percent of those who did not implement our recommendations had sales increases.

Using those who did not implement our recommendations as a control group, we can estimate the number of businesses who did implement our recommendations that had sales increases directly attributable to SBDC assistance. Using our client's sales and net income data, we can show that state and federal taxes paid on increased income as a result of SBDC assistance totaled more than $1.50 for every $1.00 of our funding.

With regard to quality, even these numbers don't tell the whole story. At the Nebraska SBDC we are proud of the recognition we have won from several organizations.

These recognitions include two prestigious awards from the American Assembly of Collegiate Schools of Business and two Leavey Awards for Excellence in Private Enterprise Education to members of our staff from the Freedoms Foundation at Valley Forge.

Our programs have also won awards from the American Institute of Decision Sciences, the National Association for Industry-Education Cooperation, and the Joint Council on Economic Education.

SBDC GROWTH

Few businesses achieve spectacular success overnight. Of the few that do, most die young. A steady, manageable growth is the best course for most businesses. So, I believe it is for SBDCs.

The Nebraska SBDC has had seven years to develop its programs, to develop its relationship with the business community, and to learn from its early successes and its early failures.

In that time we have developed several programs we believe respond well to the needs of the Nebraska small business community:

Our Rural Communities Program provides direct outreach to smaller Nebraska communities.

Our Women's Business program has provided business development training to more than 500 women business owners and prospective business owners.

Our Capital Formation Service has helped Nebraska businesses obtain millions of dollars of financing.

Our cooperative efforts with the North Omaha Community Development Corporation and the State Association of Nebraska for Minorities and Women in Business has provided assistance to dozens of minority-owned firms.

Our Computers in Business program is providing training in the use of microcomputer software to hundreds of businesses.

The small business development center program has expanded rapidly. Most SBDCs are still in their infancy. But, the experience of SBDCs who have had time to develop demonstrates that there is great promise in the program.

Supporting that promise is a genuine interest among established SBDCs in helping newer programs along the way. Members of the Association of Small Business Development Centers have been mutually supportive in ways that are rare among economic development organizations.

This is true because SBDCs represent a non-competitive form of economic development. It is true economic development that contributes to the economic growth of the entire nation rather than to the simple transfer of industry from one location to another.

A new spirit of entrepreneurism has captured America. It is a spirit that embodies the hope of America. In 1976, when the idea of SBDCs was conceived, there was but a vision of what might come. In 1984 the vision of that entrepreneurial spirit has become reality and the SBDC is an idea whose time has arrived.

Mr. NEAL SMITH. Thank you very much. I want to say I visited the Nebraska Center, and I think it is one of the ones we looked at as a model, along with Georgia and a few others.

I strongly believe that each State has to have an opportunity to have the kind that will fit their needs the best. There is no one model that will fit the needs of every State. There have to be some adjustments in it, so let me ask you this.

Suppose someone has figured out a gadget of some kind that is not, as far as he knows, available at the store. He can't find anybody that sells this gadget and he thinks that it would be saleable, so he walks into your SBDC and says "I have this idea. I've got it on a piece of paper, and I think that this is something that can be marketed and what do I do?" What would you for to him?

Mr. BERNIER. We would set him up with one of our marketing consultants to look at the market feasibility of the product, and we would conduct tests on the market feasibility of the project if that was appropriate.

If there was an engineering problem with the product, then we would refer him to the engineering assistance center at the University of Nebraska at Lincoln which is not part of our operation, but we again with respect to what is local needs and local States we don't want to duplicate with our funds services that already exist in our State.

Same thing if this was a new food product. A lot more frequent for a company to come in with a new food product than a new gadget, and we have a food processing center at the University of Nebraska at Lincoln, which we would refer them to.

Mr. NEAL SMITH. Well, what we're really interested in though is getting people that are not in business previously in lots of cases. They haven't been a small businessman, but they don't know how to get started. Would the others of you handle it any differently than what he said?

Mr. PRICER. Yes. We have a program in Wisconsin that evaluates a new innovation or invention, an idea, based on 33 criteria, some technical and some commercial.

Mr. NEAL SMITH. Are these similar to the ones for the National Science Foundation?

Mr. PRICER. This program was, in fact, funded by the National Science Foundation.

Mr. NEAL SMITH. OK.

Mr. PRICER. We thought in the beginning, Congressman, that we could then transfer an idea with a successful rating to an existing manufacturer. We found that manufacturers really are not interested in a product unless there is a tested prototype, so at one of our technical universities we now have prototype development and testing and a full new product transfer process.

Mr. NEAL SMITH. That was my next question. Do you have facilities available to develop prototypes if you think it is worthy?

Mr. PRICER. Yes, we do.

Mr. NEAL SMITH. Do all of you?

Ms. GARBER. Through various programs.

Mr. CONTE. Mr. Chairman, I am sorry. I have to go on the floor for a 1-minute. I am sorry, I missed part of the hearing, but as you know we had the Secretary of Labor across the hall. I'd like to

submit for the record, Mr. Chairman, some questions I have prepared for Mr. Cowart, and only one question here very briefly.

I am sorry that I missed the earlier discussions on this centralization issue, but I am told by counsel that they have got a pretty good thorough hearing.

My question is this. We're going to meet at 1 p.m. to mark this bill up, I understand. Would it be possible if this panel here could sit down with my counsel and see if you can work out some language to solve this problem?

Mr. NEAL SMITH. I think it would be good if we had the Associate Administrator of SBA meet with him.

Mr. CONTE. OK. I appreciate that.

Thank you, Mr. Chairman.

Mr. DAUB. Mr. Chairman? That sounds like an approach that we ought to take or else someone might object under the 5-minute rule to us sitting as a committee this afternoon for markup.

While we're debating the down payment matters of eight different budgets or so this afternoon and tomorrow, take your pick. We're going to raise your taxes to lower your interest rates, so I guess what concerns me the most about our discussion on section 4 is that the SBDC process which is so terrific and does such a good job and is commencing on what I consider to be sort of the next frontier now with this process that you go through on an annual basis of negotiating or working out an application, if you will, an agreement, and the effort that you are propelled into the free enterprise markets to do, the work that you're supposed to do isn't an island unto itself.

You are, indeed, responsible to the Small Business Administration and its network to fulfill a mandate that Congress wishes you to fulfill, and so within that framework of authority and responsibility and delegating and all of this, there ultimately has to be somebody somewhere within the administration of the Small Business Administration that says no. Awful hard for any of us to accept as we mature and develop and get a better grasp maybe even than the district director might have of what SBDC's are supposed to do, can do, how they allocate resources and can be flexible at the local level and so I guess I worry ultimately, that if in these growing pains a year-and-a-half old now under these new agreements in the SOP, we too quickly rush the other way.

We're planting the seed and the tree is starting to grow. I mean I get concerned whenever I see people come rushing back in, if you will, candidly, to say we found some problems, and we want to come back in and correct them, and yet when we get all done we're going to find out that maybe there's going to be one tree that is too sturdy and will never be flexible when maybe 31 States have flexibility and four don't, and there's a problem, so that is my thrust, and that is why I worried about the interpretation of section 4 and what is your interpretation of section 4. Would you introduce yourself for the record?

Ms. GARBER. Mr. Allen Neece who is our Washington counsel for the Association of Small Business Development Centers.

Mr. DAUB. Did he draft section 4?

Ms. GARBER. No.

Mr. NEECE. I will volunteer, Mr. Daub, that I did not.

Mr. DAUB. Did you help draft it?

Mr. NEECE. The answer to that is no.

Mr. DAUB. OK. Were you aware it was being drafted?

Mr. NEECE. We were fully aware that it was being drafted.

Mr. DAUB. Do you know who drafted it?

Mr. NEECE. Yes, counsel for the committee did.

Mr. DAUB. All right. Were you initiating some effort though to get something done along these lines?

Mr. NEECE. To answer that question, I would like to step back and maybe put this whole issue in some perspective.

Hearings were initiated by both the House and the Senate, Mr. Daub, and other members of the committee beginning in 1977 on a concept that was then called the University Business Development Center Program, and later changed to a Small Business Development Center Program.

Mr. DAUB. I am quite familiar with all of that. I think the committee is.

Mr. NEECE. But what was important in the course of those hearings was that SBA had undertaken for 25 years a management assistance program. The Congress, in its wisdom, concluded that that program was not as effective as it might possibly be. To rectify this problem it concluded that what was needed was to establish a partnership to provide management assistance.

Unfortunately the issue in section 4 has been put in an adversial perspective, and we don't mean it that way at all. What is uppermost in our minds is that this was perceived to be, and we have always believed it to be, a partnership between the States and the Federal Government.

The enabling legislation specifically provided for a deputy associate administrator for management assistance. That is a statutory position. It was unusual for the Congress to intervene in SBA and assign a specific statutory provision without regard to the civil service, I might add.

In the course of those hearings it was emphasized time and time again that to manage this program, there was a need for someone who would be strong, capable, and who could make the decisions for this program in Washington, DC, in the central office. That is why the statutory position was created.

A year ago SBA said it wanted to experiment, that it wanted the district and regional offices to be more fully included in this program. Indeed, we did work very closely with Johnnie Albertson and other key SBA officials more fully in trying to include the district and regional personnel.

That was very important because these people felt they had been shut out. We frankly had not worked closely enough with those district and regional offices. What evolved, however, over a period of time, as has been said before, is that the district directors have veto power.

We believe that this situation really doesn't reflect or adequately represent a partnership kind of relationship where the State resources are utilized—the legislature, the Governor's office, the Department of Economic Development or the Department of Commerce, whatever it might be, and the university resources coupled with those of the Federal Government. We ought not to be in a po-

sition where the district director can tell those others in a partnership relationship that this is as far as you can go.

I will give you an example. In the State of New Jersey they just passed a procurement bill, a small business set-aside measure to be exact, requiring the State of New Jersey to substantially increase its contracting with small business concerns in that State.

Reflective of what Mr. Smith said earlier, the SBDC in trying to create something that would be unique and responsive to the needs of that particular State, said what we need to do is hire persons who will reach out and counsel small business concerns, and if you will, show them how to take advantage of this new opportunity in the State. The district director said absolutely not.

I think that represents the kind of concerns we have. I can't conceive and we've never had a problem with Johnnie Albertson turning down imaginative, bold ideas. We have had a marvelous working relationship with that person.

She's a breath of fresh air. She's brought continuity. She's brought order to this program, and we think she is the greatest thing since sliced bread. We want to make that clear as an association, and we want her to have the final authority.

As Bob Pricer said earlier, you go through a very convoluted chain of command here for her to be able to tell ADMA, the Assistant District Director for Management Assistance, what to do. This is talking out of school, but she's had to get on airplanes, and go to States trying to get things turned around.

We're very critical of ourselves. We have had some weak situations.

Mr. DAUB. And when she's worried about the language, since you understand the nature of her concerns, I would trust from listening to her testimony, does not that give you cause in her wisdom, if she's worried about this language in an objective way to as well be concerned about the potential restrictiveness of it in a way that may not have been intended in the first place?

Mr. NEECE. Well, I would submit that it is a function of how one might interpret.

Mr. DAUB. That is what I am asking you, for your interpretation. That was my original question. All things boiled down, what do you interpret this to ultimately——

Mr. NEECE. The district director and the ADMA under no circumstances have been dealt out of this picture. The proposed statute makes it very clear after consulting with, and that is exactly what we intend to do as an association, and that is what our members intend to do.

Mr. DAUB. You think you get a faster decision on an agreement or the contents of an agreement out of the Federal central system than you would out of going through the process of six different potential stops on the way up to get this thing resolved.

Mr. NEECE. If I understand your question the answer is yes.

Mr. DAUB. Wow. Think the Federal Government is going to answer you?

Mr. NEECE. If the question is do we go through——

Mr. DAUB. For 2 years.

Mr. NEECE. Is the thrust of the question do we need to go through seven steps?

Mr. DAUB. Well——

Mr. NEECE. Absolutely not. We want one step, and that is you pick up the telephone and you call Johnnie Albertson. That is a thrust of this proposal.

Mr. DAUB. Neither she nor I nor you are going to be around for ever. Administrators and people change and I think you have to look at policy now and not the people involved. Ultimately when you make decisions like this that are going to end up writing things into the law, into an authorization bill that could be as much as 3 years in duration with no attempt then, no possibility of renegotiating all these things in an SOP.

A year from now when you find out that this doesn't work——

Mr. BERNIER. Congressman, I agree that as far as I am concerned, most often you can reach agreement on the local level more quickly than you can reach agreement on the national level, and we've had no problems in Nebraska with respect to negotiating programs in the district. I think what it comes down to is that when there is an impass between the SBDC director and the district director of the SBA then there needs to be some method of getting beyond that impass besides saying well, the district director has the right to not approve.

I think that in most districts, in most SBDC's the relationship between the local district office and the SBDC director has been good. We have had no problems in Nebraska. We've gotten our programs set up in Nebraska without any difficulties and in getting decisions faster than going through the process of the central office.

Mr. DAUB. Well, the point I would want to add is that simply when you have got a couple of problems out there and they may even in the future be. I, as a business graduate, look at management by objective, and I say you go out and solve your four problems. You don't throw the baby out with the bath water necessarily at a point that is not 2 or 3 years into it.

If we had 3 years of experience and you all were coming here telling me that boy this is really getting out of hand, but when we've only been at it a year or a little less, and there have been four or five arguments, I worry, just because I want to be cautious. I want to err on the side of your own potential to grow, and not ultimately to find that quietly the administration starts to decide that every agreement has to be boiler plate, and if this provision isn't in all 35 agreements, and some one person can start to get very adamant about something.

Ms. GARBER. I think on the other side of that same argument, obviously that was something we're up against, the fact that there is a severe time pressure and a lot of things have been compressed into a very short period of time for analysis and for decisionmaking.

Certainly we as an association and myself personally believe a lot of these things will be resolved through policy, but it's very scary to us to hear that we've got language in an SOP that is difficult to change, and that we're going to get language into policy that is going to be difficult to change. When you look at the picture as a whole, I guess you have to go with your gut feeling as to what direction the thing is going in.

In reviewing this language and deciding what position to take, I think a lot of things that have happened in the last year besides specific problems in States, but kind of in undertone, lead us to believe or lead me to wonder and be concerned with the fact that the program is headed toward an SBDC being an arm of the district office and being an SBA delivery service, and that is not what it was intended to be.

Mr. DAUB. Let me tell you. I will never legislate on the basis of assumptive observations of overtones.

Now I want you to know that I am concerned about what you say. I also know that we're going to probably have a vote here in a minute. Conte is on budget here, and I want to be careful that you have at least a little time, an hour, to get together here and meet in this room for a little while before we go to markup.

Last point, different subject. Do any of you have any problems with section 5 dealing with SBDC's using commercial type facilities to the extent practicable? Anybody have any problem with that in section 5?

Ms. GARBER. With the extent practicable, I think the SBDC's can live with that. I just want to stress in that instance, based on the testimony that was given this morning, sometimes commercial locations are inappropriate. I certainly think that an SBDC has to reach distant communities or minority communities or specific communities, but the outreach is a lot more important than the location.

That is what we concentrate on.

Mr. BERNIER. I have a question about the word commercial. You know, we have facilities in downtown Omaha and the State office building on the street level with parking across the street, and very accessible office-type off-campus facilities, but it is not commercial in the sense that I think of commercial.

It is not like a K-Mart.

Mr. DAUB. I see your point.

Mr. BERNIER. It is in the downtown business district. I don't know if there's a better word.

Mr. DAUB. Acceptable might be a better word than commercial. Does counsel have any reason for that particular word being used other than to get the point across that it should be accessible or storefront or——

Mr. POWERS. Storefront.

Mr. DAUB. Was what was intended? Appreciate the comment. We'll take a look at that. Did you have a comment?

Mr. CICCARELLI. I don't think commercial is important as accessible. Remember going into some type of commercial facility may also, in turn, lead to a higher cost. I mean we have—one of our offices in a commercial facility, and it costs us somewhere in the neighborhood of $10,000 in rent, electricity, various other overheads.

I think as long as that office is accessible to the small business community, in addition, accessible to the resources that are needed to assist that client, that is what is important.

Mr. DAUB. Would you all comment or the association of any of you welcome for the record by letter, we'll save some time, there was a question asked by Mr. McDade, my ranking member on the

Republican side about letting for-profit commercial ventures participate.

You all remember that question, in SBDC work.

Now I would appreciate your input on that. It is not necessarily germane to this particular legislation or the purpose of the hearing today. I am very interested in that subject, and I would welcome any of your concerns or support or opposition to that idea. If you need more elaboration on that, Mr. Chairman, we'd offer that later, but it is an interesting idea, and one that I think we'd benefit early on from your views before we get busy on something.

That's all I have, Mr. Chairman. Thank you very much.

Mr. NEAL SMITH. Thank you.

Mr. DAUB. I commend you to your effort here, the next 55 minutes if you will cooperate, and we would appreciate your input.

Mr. NEAL SMITH. I hope the hearing hasn't focused so much on trivialities that we missed the big picture here, because the big deal is that we've actually got working in a number of States now the kind of help that would permit a person with just an idea to get from there to where he knows whether or not he should go into business or given advice on how he might proceed and gets to the place where he might potentially at least become a small businessman, and we have a formula which requires a minimum of 50 percent non-Federal participation, and do any of you have any quarrels with the overall legislation?

Ms. GARBER. In looking at the 50-percent participation of the match—the association would just like to stress that university participation is an important aspect of that 50 percent, and it does, in fact, represent real cost to the participating institutions, and that is an important consideration to keep in mind when determining that 50 percent—the 50 percent is invaluable. It not only represents a financial commitment on the part of participants—all contributing parties or normally the private sector, the State, the Federal Government, and the universities.

It also represents a commitment in a lot of other ways, you know, as those people become stake holders in the program. The university's commitment is very real, and I would just like to emphasize that it does represent cash to the universities.

Mr. BERNIER. I might also mention with respect to the 50 percent and this local control issue, besides the State appropriated fund being in the university's overhead waiver, we also receive more than $43,000 in in-kind cost from chambers of commerce in Nebraska, and $25,000 or $30,000 each year from the University of Nebraska Foundation, and when we talk about local control, it is important to me that non-SBA locals are involved in the process as well as the SBA locals because they have money investments that they want to see how they're being spent as well.

Mr. NEAL SMITH. And most of you have considerably more than 50 percent.

Ms. GARBER. Yes.

Mr. NEAL SMITH. There's considerably less than 50 percent Federal money in your program.

Ms. GARBER. Yes.

Mr. NEAL SMITH. Thank you very much.

Mr. NEECE. Mr. Chairman, in our attempt to find an accommodation in the next few minutes, would it also be appropriate to have both the minority staff director and your general counsel? The SBA, I trust, will join us in this endeavor.

Ms. GARBER. And in closing may I just say that the association welcomed the opportunity to participate and really has appreciated the support of the committee, Mr. Chairman and the members of the committee and Mr. Powers in this effort.

Thank you.

Mr. NEAL SMITH. Thank you.

[Whereupon, at 12:10 p.m., the subcommittee adjourned, to reconvene subject to call of the Chair.]

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